

Chapter - One

Introduction

1. Background of the study

Capital structure plays a vital role in the real life on an enterprise. It is cardinal factor to be taken into consideration while designing the optimal capital structure of an enterprise. Capital structure decision of an enterprise affects the cost of capital through the risk complexion and ultimately the value of an enterprise. So, financial manager should try his/her best to minimize the overall cost of capital by optimizing the capital structure decision & maximize the value of an enterprise.

Development of every country is related with economic development. And for economic development banking institutions are very essential. They are the one of the most important of all modern day institution economic development is associated with everyday's trade, commerce and banking sector has important role to play for the development of such trade and commerce. They are becoming the part for modern economic sector. Because of wide variety of facility and services banking sector helps to foster industrial, commercial. Social to be more precise all sector of economy.

To do this Bank deals with money by polling together the saving of community and arrange for their productive use through creating credit . They supply the financial needs of modern business by various means. All these are the primary function of bank. But modern Bank's are not only restricted to the performance of these primary function. Apart from financing , they also render services by undertaking a wide variety of agency

and general utility functions like collection of cheques, payment of cheques, safe deposit of valuables, locker facility ,Transfer of funds etc.

The origin of word 'Bank' is believed to be from the latin word 'Bancus', Italian 'Banco', Or Frence word 'Banque'. All these means bench which is used for keeping records and exchange of money. According to another view point, the origin of word Bank is from German word 'Banck' which means joint stock fund.

The concept of banking is developed from the history which the effort of ancient gold smiths who developed the practices of storing people's gold and valuables. They received valuables and used to issue a receipt to the depositors. As such, receipts are good for payment equivalent to the amount mentioned, it became like the modern cheque, used as a medium of exchange and means of payment. This practice lasted till 12th century. From 12th century onwards it took a new trend with the establishment of the 'Bank of Vanice' in 1157 A.D. and ' Bank of Barcelona ' in 1401 A.D. the establishment of the later was the beginning of the new era with efficient management and organized approach. It was thus called the modern Bank.

After 17th century ,the wave of establishing Bank swept all over the world. ' Bank of Haimber ' in 161 A.D. in Germany and 'Bank of England' 1694 A.D. where the prominent ones established during this period. Hither word, the Banking business, which was limited in hands of few people, began expanding and banking business became inequitable for the entire globe.

The history of banking in Nepal as compared to other developed countries is of recent origin. Since economic development is a recent phenomenon for Nepal, so is the development of banking sector. Although primitive form of

banking transaction like that of loan were prevalent since long, the modern bank quite recently. The history of modern bank dates back to 1994 B.S. when Nepal Bank Limited was established during the reign of Juddha Samsher. Since then a long time passed before Nepal Rastra Bank came into being as the central Bank of Nepal under 'Nepal Rastra Bank Act, 2012' Rastriya Banjiya Bank established, in 2022 B.S. being as a second commercial Bank of Nepal then in 2041 B.S owing to the liberalization and privatization policy adopted by government in 2039 B.S, another landmark was achieved in the history of commercial banking in Nepal with the establishment of Nepal Arab Bank (*now changed into Nabil Bank*). It was the first joint venture bank and also the introduction of private investment in Banking Sector. It became a grand success and banking sector experienced a boon in the history of joint venture banks.

Nepal Indosuez Bank(2043), Nepal Grindlays Bank - 2043 (*now changed into Standard Chartered Bank*), Himalayan Bank Limited(2043), Nepal SBI Bank (2050), Everest Bank Limited (2051), Nepal Bangladesh Bank(2051), Bank of Kathmandu(2051), Celon Bank of Nepal(2053) were some of the prominent banks established as joint venture undertaking.

It has to be found various definition of Bank.

- "Any institution Offering deposit subject to withdraw on demand and making loans of commercial or business nature is bank ". – *Federal USA Law*
- I believe in that fact that Banks are not merely Purveyors of money but also in an important sense manufacturer of money. (Sayers, 1994:216)

- A Banker is dealer in debt in his own and other peoples, the Banker business is there to take the debt of other people to offer his own in exchange and thereby to create money. Although there are various types of Banks according to their nature and function, but only commercial Banks are considered here for this study. (Crowther, 1995 :417)
- A Commercial Bank means Bank which deals in exchanging currency, acceptind deposits, giving loans and doing commercial transaction (Commercial Bank Act 2031 B.S.)

Commercial Banks are being run by bank and financial ordinance 2060, which has replaced the previous commercial bank 2031. The ordinance has been amended once. According to ordinance, Bank and financial institutions are divided into four groups. Commercial Banks are placed in group A . There are many commercial banks operating in Nepal, And many are about to establish. Since this thesis report is based on Nepal SBI Bank Ltd, Laxmi Bank Ltd, & Everest Bank Ltd, information about is necessary and given below.

1.1. At Glance

1.1.1 Nepal SBI Bank Limited

Nepal SBI Bank Limited is one of the leading joint venture bank. It was established in 2050 B.S. under the “Company act 2021” and “Banijya Bank Act 2031 B.S.” as a joint undertaking with State Bank of India. This Bank started its operation with an authorized & issued capital of 200

crores & 87.45 crores and paid up capital of 12 crores. Out of which 55% was invested by State Bank of India, 15% by employee provident fund (EPF) and the rest 30% is from the general public of Nepal through issuing shares .

This Bank has been able to secure an outstanding position among the commercial bank. It is able to draw the attraction of many people due to its customer friendly approach .Owing to its experience of international banking transaction round the globe . It has better reputation and goodwill among the commercial bank. Today this banks with 42 existing branches, 1 proposed branches, 4 extension counters and a team of 256 enthusiastic, dedicated and efficient employees have been able to satisfy its customers with fast, easy and reliable banking services. The principal activities of the bank during the year were personal and cooperate financial services, international network services, foreign currency exchange dealing etc. Apart from the traditional banking services, the bank has entered into the new era generation next banking by providing ATM services, credit card, safety deposit locker, remittance services, letter of credit and many other such services.

The main Pillar of support for Nepal SBI Bank Ltd are its customers, shareholders and its employees. It is Bank's mission to deliver quality banking and stakeholder satisfaction in the true meaning of the word. Bank fully grasp the ultimate importance of engaging more closely in customer relations at every level, ensuring satisfactory, sufficient profits and ploughing back the fruits of the business success back to customers, the community and shareholders.

Nepal SBI Bank's code of conduct encapsulates international best practices applicable to Nepali context. The level of commitment of the people to take SBI Bank to greater heights has been a huge catalyst. The team Spirit Within the organization is something the Bank is proud of.

Table 1.1: Capital structure of Nepal SBI Bank Limited. Based on annual report 2009/2010

(Rs. '000)

Particular	Amount	%
Share holders capital	1,653,624	67.69
Reserve & surplus	589,229	24.13
Debenture & bond	200,000	8.18
Total Debt & Liabilities	2,442,853	100

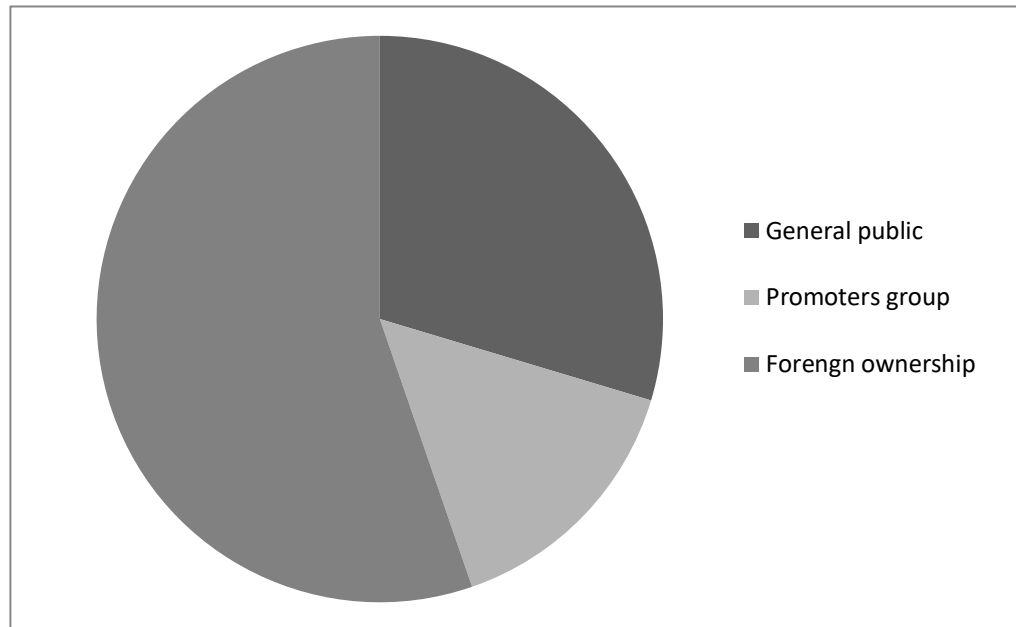
Source: annual report of Nepal SBI Bank Ltd 2009/10

Table 1.2: Ownership of equity capital of Nepal SBI Bank Ltd.

Particulars	% of owners equity
General Public	29.64
Promoters Group	15.08
Foreign ownership	55.28
Total equity	100

Source: Annual report of Nepal SBI Bank Ltd. 2009/10

Fig. 1.1: Graphical presentation of ownership of equity capital



Source: Annual report of Nepal SBI Bank Ltd. 2009/10

1.1.2 Laxmi Bank Limited

Laxmi Bank was incorporated in April 2002 as the 16th commercial bank in Nepal. Laxmi Bank merged with HISEF Finance Ltd., a first generation financial co. which was the first ever merger in nepali corporate history. The current share holding constitutes of promoters holding 55.42 percent, general public holding 35.56 percent .Promoters represent Nepal’s leading business families with diversified business interests. The banks shares are listed and actively traded in the Nepalese stock exchange .

Laxmi Bank has 9 branches inside Kathmandu valley including 2 new branches added this year at Lagankhel & Susedhara. Laxmi bank has grown with branches in Birgunj, Banepa, two in Pokhara, Biratnagar, Narayanghat, Pulchowk, Lalitpur, Teku, Newroad, Janakpur, New Baneshwor and more recently in Damak. Similarly 4 new branches added outside Kathmandu valley this year 3 in west at Nepalgunj, Butwal & Bhairahawa and One at Parsa, Chitwan. Following the merger with HISEF finance Ltd., a decade old first generation finance company, its office in Hattisar, Kathmandu was converted to that of Laxmi bank. This office was converted to a full branch and the corporate office in October 2005.

With a view to providing safe, seamless, quick and advance banking services, the bank has been heavily investing in contemporary banking technologie. The bank uses flexcube as its main banking platform. Flexcube incidentally has been ranked the number one selling core banking solution globally, and has been embraced by over 500 financial institutions across over 90 countries. The bank provided each its services through a host of delivery channels including cellphone, internet, Atm, point of sales(POS) etc., In audition to a network of physical branches. The internet banking facility comes with capabilities of on line shopping in addition to regular internet banking features. Similarly through the bank's alliance with smart choice technologies(SCT), the Atm/Debit card holder of laxmi bank has access to a network of Atm's, and POS terminals located in all major urban centres of the countries. The bank is the first in South Asia to have implemented SWIFT net, the advanced version of the SWIFT technology , which is used for speedy and secure payment and

messaging services. Laxmi bank's ATM network is now spread over 17 locations in 8 cities Kathmandu, Lalitpur, Birgunj, Pokhara, Itahari, Butwal, Banepa & Nepalgunj. In 2007 Laxmi Bank became the 5th bank in the country to issue credit card. These cards can be use in 30,000 ATMs and 300,000 merchant outlets across Nepal & India.

Under a professional management team, the bank has established itself as an emerging key player. Today the bank is recognized as an innovative and progressive bank geared to providing shareholders and customers with quality earnings and value added services. Transparency, good governance, and sound business growth are the driving forces

Table 1.3: Capital structure of Laxmi Bank Ltd. Based on annual report 2009/2010

(in Rs. '000)

Particular	Amount	%
Share holders capital	1,098,086	51
Reserve & surplus	245,133	11
Debenture & bond	350,000	16
Borrowings	450,000	22
Total Debt & Liabilities	2,143,219	100

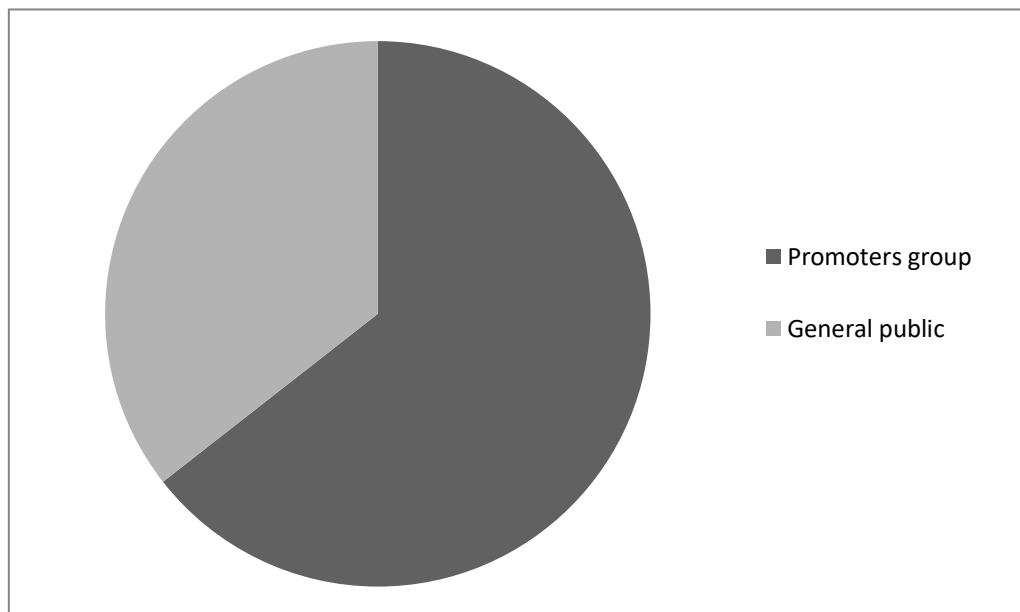
Source: Annual report of Laxmi Bank 2009/10

Table 1.4: Ownership of equity capital of Laxmi Bank Ltd.

Particulars	% of owners equity
General Public	35.56
Promoters Group	64.44
Total equity	100

Source: Annual report of Laxmi Bank 2009/10

Fig. 1.2: Graphical presentation of ownership of equity capital



Source: Annual report of Laxmi Bank 2009/10

1.1.3 Everest Bank Ltd.

Everest Bank Limited (EBL) started its operation in 1994 with a view and objectives of extending professionalized efficient banking services to various segments of the society. The bank is providing customer friendly services through branch network. Punjab National Bank (PNB), the joint venture partner (holding 20% equity in the bank) is the largest nationalized bank in India having 110 years of banking history. Everest Bank Limited has been conferred with “Bank of the Year 2006, Nepal” by the bankers, a publication of financial times, London. All the branches of the bank are connected through Anywhere Branch Banking System (ABBS), which enables customers for operational transactions from any branches.

The bank was bestowed with the “NICCI Excellence award “ by Nepal India Chamber of Commerce for its spectacular performance under finance sector recognizing the value of offerings a complete range of services, the bank have pioneered in extending various customer friendly products such as Home Loan, Education Loan, EBL Flexi Loan, EBL Property Plus (Future Lease Rental), Home Equity Loan , Vehicle Loan, Loan Against Share, Loan Against Life insurance.

EBL was one of the first bank of introduce Any Branch Banking System (ABBS) in Nepal. EBL has also introduced mobile vehicle Banking System to serve the segment deprived of proper banking facilities through its Birtamod branch, which is the first of its kind. The banks performance under all parameters has been outstanding during the fiscal year 2063-64 after providing for income tax and statutory

provisions. The bank has opened 5 more branches during the year 2066/67. The total branch network of bank till now is 37.

Everest Bank is first private commercial bank having largest network. Promoters hold 50% Stake in the Banks equity, while 20% of equity is contributed by joint venture partner PNB whereas remaining 30% is held by the public EBL in association with Smart Choice Technology (SCT) is providing ATM service to its customers through more than 74 ATMs and over 850 Point of sales across the country . EBL is playing a Pivotal role in facilitating remittance to and from across globe. Being the first Nepalese bank to open a representative office in Delhi, India, the Nepalese in India

Table 1.5: Capital structure of Everest Bank Ltd. Based on annual report 2009/2010

(in Rs. '000)

Particular	Amount	%
Share holders capital	830,467	2.12
Reserve & surplus	1,479,530	3.74
Debenture & bond	36,932,310	93.39
Borrowings	300,000	0.75
Total Debt & Liabilities	39,542,307	100

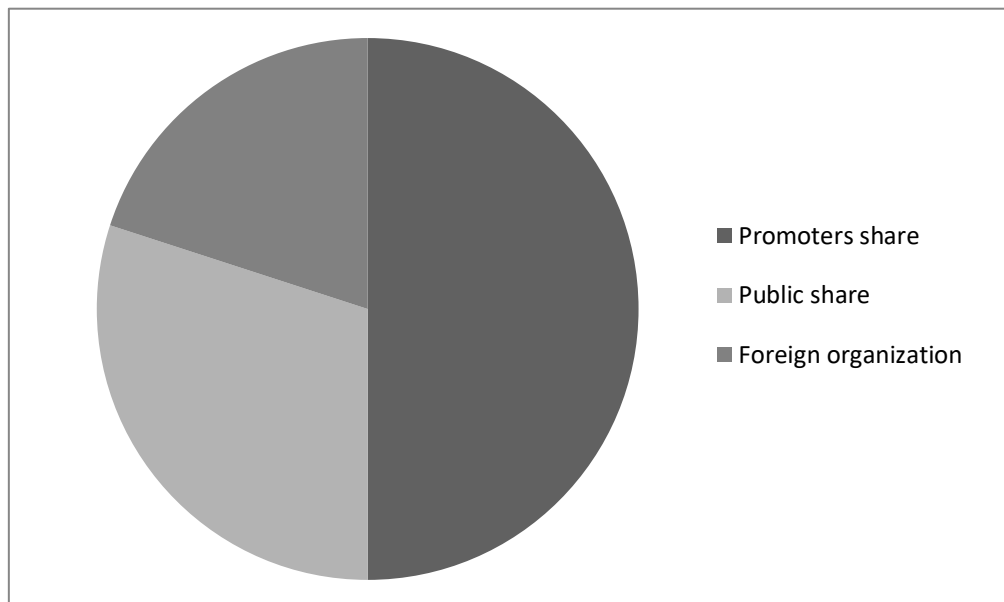
Source: Annual report of Everest Bank 2009/10

Table 1.6: Ownership of equity capital of Everest Bank Ltd.

Particulars	% of owners equity
Promoters Share	50
Public Share	30
Foreign organization	20
Total equity	100

Source: Annual report of Everest Bank 2009/10

Fig. 1.3: Graphical presentation of ownership of equity capital



Source: Annual report of Everest Bank 2009/10

1.2. Focus of the study:

Capital is the most crucial factor from beginning of the business organization. In the lack of capital, business organization cannot operate their daily activities properly. Therefore, to ensure the smooth operation of the firm, it must take into account its capital structure. Capital structure concept holds a major place in the financial management including the banking institutions. Capital structure refers to the proportion of debt and equity capital. A perfect balance between debt and equity is required to ensure the trade-off between risk and return. Since capital structure is the liabilities part, therefore, it is highly riskier and sensitive. Debt equity ratio indicates the extend to which debt financing is used relative to equity financing. Dividing total debt by shareholder's equity, this ratio is calculated. Total debt consist of current liabilities and long term debt whereas shareholder's equity consist of owner's fund, reserve and surplus, retained earning etc

The proper composition of debt and equity helps to generate high return to the business organization and helps in long -term solvency. Investors invest their funds in ownership securities or debt securities of the organization with the expectation of getting favorable return in the future. In the absence of proper utilization of the capital, it fails to meet their expectation and minimizes the credit worthiness of the organization and leads to fall the market value of the organization. On the other hand, optimum financial structure makes better use of society's fund and thus it increases the total wealth of the society.

1.3 Statement of the Problem:

The two principal source of long-term financing are equity and debt capital. The composition of these two financing is known as financial structure or capital structure. One of the critical of all banking problem in recent years centres on raising and maintaining sufficient capital. A commercial bank has access to their source of funds: capital, deposits, and borrowing. Collection and maintenance of proportion of capital from different sources from the capital structure and the way of raising it has important implication for bank's profitability because as the debit increase interest payable also increases and it will lesser the shareholder's profit has the capital structure of commercial bank adequate or not?

1.4. Objectives of the Study:

The main objective of the study is to provide brief information about the comparative analysis of capital structure and the overall performance of Nepal SBI Bank Limited, Laxmi Bank Ltd. & Everest Bank Ltd. On the basis of this, other subsidiary objectives are:

- To have precise insight about the capital structure of said bank.
- To find out factors affecting capital structure management decision.
- To analyse capital structure related variables.
- To calculate capital structure ratio.
- To examine long-term solvency of the said bank.

- To evaluate debt servicing capacity of the above bank.
- To show the trend of composition and capital of the sample bank.
- To find the capital adequacy/ sufficiency ratio of the said bank.
- To find out profitability position of the above bank.

1.5. Assumption and Limitations of the Study

A research is a vast study investing of the subject matter for solving research problem. Every type of conceptual work has its certain assumption and limitation behind it. Similarly, this study considers the following limitations:

- The duration available for the study was very short. For a good research work the time available would not be enough even to collect data.
- This study just analyse the capital. It excludes other components.
- Many seasonal factors is based on the historical data. So the facts by the study may misguide for the future. It may be inappropriate for the study.
- The study is based on mostly Secondary data. Therefore, conclusion drawn may not be fully true in real situation.
- The analysis is based on the limited year. Therefore, it is difficult to analyse the overall performance of the bank.

1.6. Significance of the Study:

The financial institutions holding lenders and owners are most concerned with the firm's long-term financial strengths. To judge the long-term financial position of the firm. Capital structure and profitability of the firm are worthy to analyse. Capital structure and profitability would help to indicate and to follow the appropriate mix of debt and owner's equity in financing the firms asset's where profitability analysis would help to indicate the condition of earning from the various resources and to allow the appropriate profitability pattern. A firm having good return and efficient management is supposed to be better and bright in the future. Therefore, to this significance on account, this study on behalf of the firm's capital structure and profitability and its relationship is justified as a specific subject matter.

1.7. Scheme of the Study:

This study is accomplished according to approved general format of thesis of Tribhuvan University. Formalities and styles are those adopted in the study is not new but followed the senior, which make the study possible to come in this form and format. This study includes the following five chapters.

- Introduction: This chapter contains the introductory part of the study. This chapter describes the focus of the study, statement of the problem along with objectives, limitations, significance and scheme of the study.

- Review of Literatures: This chapter includes conceptual framework and related different studies.
- Research Methodology: This chapter describes the research methodology employed in the study . This chapters deals with research design.
- Presentation and analysis of data: Data Processing , data analysis and interpretation are given in this chapter. Mainly capital structure analysis includes different trend analysis, analysis of leverage and ratio analysis such as debt equity ratio, debt ratio, interest coverage ratio, capital sufficiency ratio.
- Summary, conclusion and recommendation: The last chapter contains the findings of whole study after which major conclusions and recommendations are provided.

Chapter-Two

Review of Literature

2.1. Introduction

Review of literature is the process of reviewing the available material relating to the particular research work. The purpose of review of literature is to receive source idea for conducting research and to find out what research studies have been conducting.

Review of literature is a chapter where a researcher reviews the books, journals, magazines or any other types of studies, which are related to his/her field of study. Research is a continuous process & hence the procedures & the finding may change due to continuous research for getting the power and ability. If analysis & interpretation of data a researcher must review his/her literature about his/her field of study.

The purpose of reviewing the literature is to develop some expertise in one's area to see what new contribution can be made and to receive some ideas for developing research design. Thus, the previous studies can't be ignored because they provide the foundation to the present study. So the books & previous studies related to this field of study might provide the present study with the past research may be provided. Some Nepalese & foreign books, journals & magazines and other related handouts are reviewed & the findings have been presented in this chapter.

2.1.1. Conceptual review:

The term capital has a special meaning in the balance sheet of bank. Capital refers to those funds contributed by the bank's owner, consisting mainly of stocks; reserves & earning that are retained in the bank rather than paid out to the stockholders. Outsider's loan is instruments of in debtness. But these loans are used by bank as a permanent part of capital structure. Capital is a scare source and is much more essential to maintain smooth operation of any firm . The available capital and financial source should be utilized so efficiently that could generate maximum return.

Capital structure refers to the mix of long term sources of funds, such as debtness, long_term debt, preference share capital & equity share capital including reserves and surplus (Pandey: 1999:18). The optimum capital structure may be define as that capital structure or combination of debt and equity that leads to the maximum value of the firm(Khan and Jain:1990:487). Capital structure is the permanent financing of the firm, represented primarily by long-term debt, preferred stock and common equity, but excluding all short- term credit. Thus, a firm's capital structure is only a part of its financial structure.

Capital Structure is very crucial part of the financial management as the various composition of debt and equity capital may impact differently on risk and rate of return to equity shareholders. The funds required to business enterprises are raised either through the ownership securities (i.e. equity share and preference share) or creditors share (i.e. debenture or bonds). A business enterprise has to

maintain proper mix of both the securities in a manner that the cost and the risk perception to the shareholders are minimized. The mix of different securities is portrayed by the firm's capital structure (Koirala, 1990:105)

Capital structure theories developed so far for the question of existence of optimal capital structure. Most of the theoretical and empirical debates so far are revolved around the maximization of the value of firm through the judicious composition of its debt and equity fund. At the time of expanding the branches of commercial bank, emphasis was given to the deposit mobilization and credit disbursement. Subsequently, the banking sector faced the problem of bad debts, overdue loans, accrued interest, and accumulation of the non-banking assets and excess liquidity in the banking system. In addition to these expected happenings new challenges were added to the Nepalese banking sector due to the adverse development in the domestic economy resulting from the deteriorating peace and security situation & continuous persistence of natural calamities inside the country on one hand & the global recession primarily caused by international terrorism on the other. To overcome such credit risk, capital is a must. Viewing the need of capital for commercial banks Nepal Rastra Bank in a risk came with the 'Capital Adequacy Framework' to run commercial banks in a risk free environment.

The capital adequacy framework outlines the Nepal Rastra Bank's proposed guidelines of the revised international convergence of capital measurement and capital standard popularly known as Basel 2. Basel 2 is a new international capital standards set by the Basel

Committee on Banking Supervision (BCBS). Basel Committee on Banking Supervisions (BCBS'S) recommendations on capital accord are important guiding framework for the regulatory capital requirement to the banking industry all over the world and Nepal is no exception. Now, the BCBS came out with Basel II framework which seeks to provide regulatory capital requirements that are more comprehensive and more sensitive to risk. Basel II is a major revision of the international standard on Bank's Capital adequacy, which requires banks to implement risk management policies that align capital adequacy assessment with underlying credit risk, market risk and operational risk. Basel II establishes a more coherent relationship between how supervisors assesses regulatory capital and how they supervise banks, enabling examiners and better evaluate whether banks are holding prudent capital levels compared with their risk profiles. In nutshell, the basic theme of capital adequacy framework based on Basel II is that for every kind of assets of bank there must be some amount of capital back up so that all the credit risk, market risk & operational risk can be avoided.

The capital adequacy framework also emphasis on capital and optimum capital structure.

Assumptions:

The following assumptions are made to grasp the elements of the capital structure and the value of the firm or the cost of capital controversy properly (Van Horne;1985:243)

- Firms use only two sources of capital i.e. debt capital and equity capital.
- the corporate and personal income taxes do not exist. This assumption is relaxed later on.
- the total assets of the firm are given. The degree of leverage can be changed by selling debt to repurchase shares or selling shares to retire debt.
- the firm has a policy of paying 100% dividends.
- the operating earnings are not expected to grow.
- the business risk is assumed constant and independent of capital structure and financial risk.

In the analysis of capital structure theories, following notations are used:

S =market value of ordinary shares

D =market value of debt

V =total market value of the firm

K_d =Cost of debt

K_e =cost of equity

K_o =overall cost of capital

$EBIT$ =earning before interest and taxes or NoI

2.1.2 Theories of Capital Structure:

The following theories have been emerged on capital structure. They are:

- Net Income Approach (NIA)
- Net Operating Income (NOI) approach
- Traditional approach
- Modigliani – Miller approach

i. The Net income Approach(NI Approach)

The net income approach is also known as relevant theory of capital structure , as the capital structure decision is relevant to the valuation of the firm . This approach contends that the value of a firm can be maximized by the proportion of debt minimize in the capital structure and minimize the overall cost of capital. The crucial assumptions of this approach are as below (Pandey ; 1999:26)

Assumptions of NI approach:

- (a) The use of debts doesn't change the risk perception of investors , as a result the equity- capitalization rate (K_e) , and the debt – capitalization rate (K_d) , remains constants with changes in leverage.

(b) The debt capitalization rate is less than the equity – capitalization rate ($K_d < K_e$)

(c) The corporate income taxes do not exist.

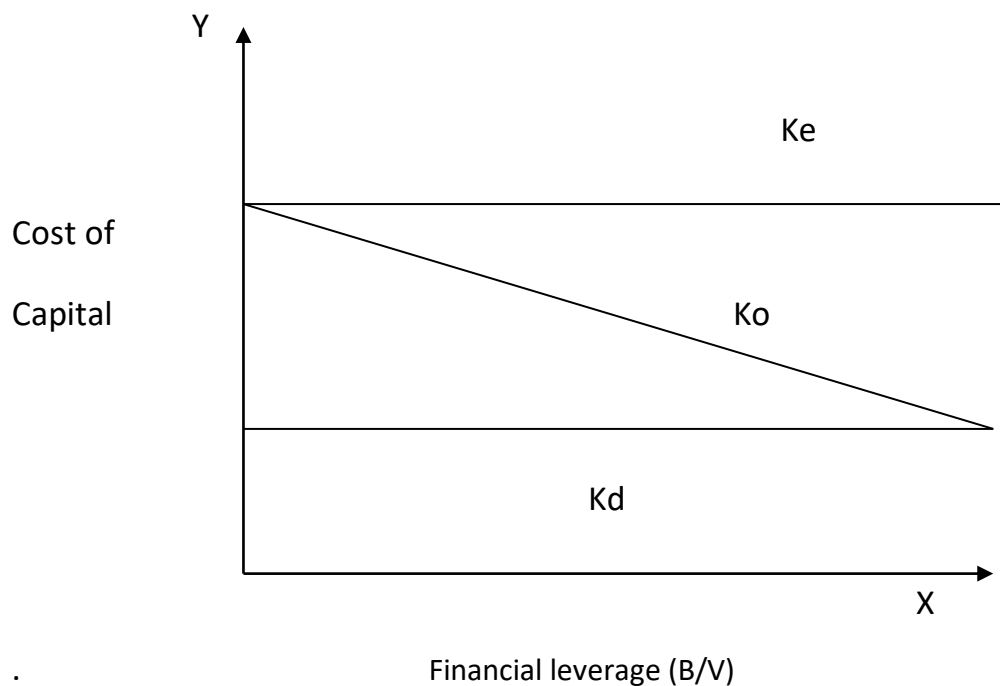
The overall cost of Capital (K_o) can be measured as:

$$K_o = \text{NOI}/V \text{ or } K_o = \text{EBIT}/V$$

$$\text{Or, } K_o = K_e - (K_e - K_d) D/V$$

The assumption of the NI approach shows that K_e and K_d are constant and K_d is less than K_e . Therefore, K_o decrease as D/V increases.

Fig 2.1: the effect of leverage on the cost of capital under NI approach



Under NI approach, K_e and K_d are assumed not to change with leverage. When the proportion of debt is increased in the capital structure, it causes overall cost of capital to decrease and approach the cost of debt. Thus, the firm will have the maximum value and lowest cost of capital when it is all most debt- financed , under the NI approach.

ii. The Net Operating Income Approach:(NOI Approach)

The NOI approach contends that capital structure is irrelevant to the cost of capital and value of firm. Thus, it is called irrelevancy theory of capital structure. As per this approach the market value of the firm is not affected by the change in capital structure. The market value of the firm is found out by capitalizing the net operating income at the overall cost of capital, K_o , which is a constant.

The market value of the firm is determined as:

$$V=D+S$$

$$\text{Or, } V=EBIT/KO$$

Where, K_o is the overall capitalization rate depends on business risk of the firm. It is independent of financial mix , V will be constant and

independent of capital structure changes. The critical assumptions of NOI approach are (Pandey;1999:31)

Assumptions of NOI approach:

- The market capitalizes the value of the firm as a whole. Thus, the split between debt and equity is not important.
- The market uses an overall capitalization rate (K_o) to capitalize the net operating income, K_o depends upon risk.
- if the business risk is assumed to remain unchanged, K_o is a constant.
- The use of a less costly debt funds increases the risk of shareholders. This causes the equity capitalization rate to increase. Thus, the advantage of debt is offset exactly by the increase in the equity capitalization rate (K_e)
- K_d is a constant.

The corporate income taxes do not exist.

The market value of equity can be determined as:

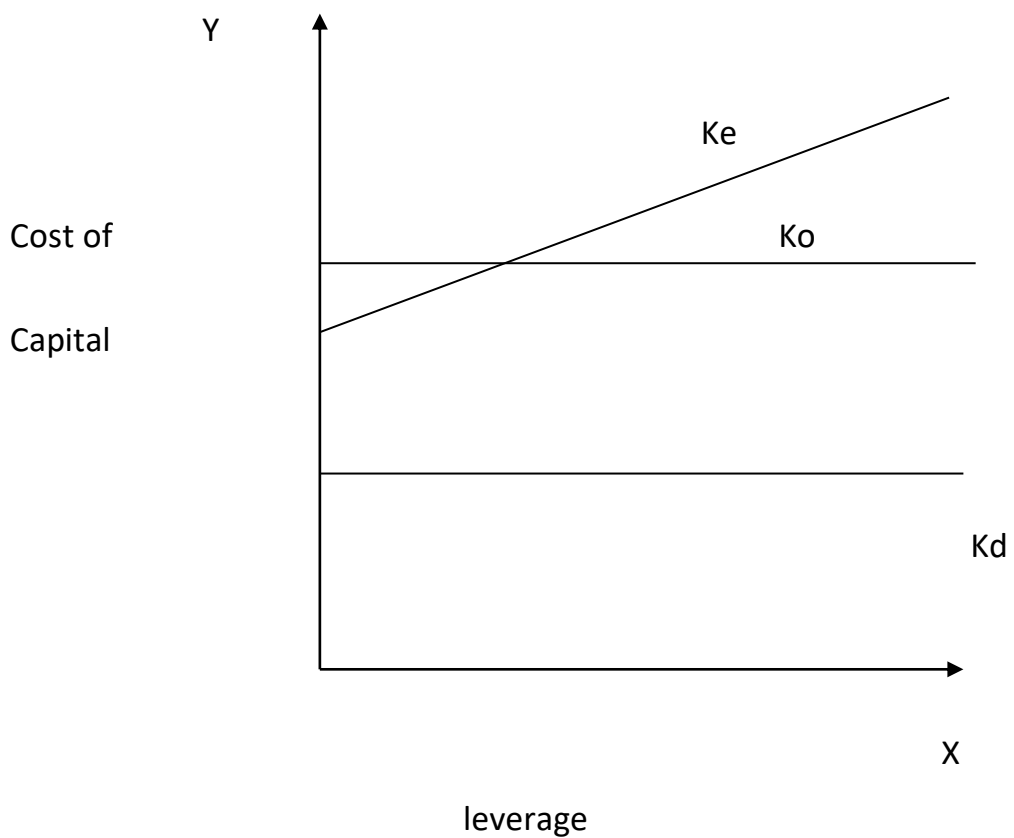
$$S = V - D$$

The cost of equity can be defined as follows:

$$K_e = K_o + (K_o + K_d)D/S$$

The equation indicates that K_e increases with leverage continuously, if K_o and K_d are constant.

Fig 2.2: The effects of leverage on the cost of capital under NOI approach



As the average cost of capital, K_o is constant this approach implies that there is not any unique optimum capital structure. It means, every capital structure is optimum, as the cost of capital is the same at all capital structure.

iii. The traditional view:

The traditional view (Solomon; 1969: 139), which is known as an intermediate approach is a compromise approach between the net income approach contends that overall cost of capital of the firm can be minimized by judicious mix of debt and equity capital. This view clearly implicates that the cost of capital decreases within the reasonable limit of debt and the increase with leverage. Thus, an optimum capital structure exists and it occurs when the cost of capital is minimum or the value of the firm is maximum. This theory carries the simple implication that the cost of debt plus the cost of equity together on a weighted basis, will be less than the cost of equity, which existed on equity before debt financing.

According to the traditional position, the manner in which the overall cost of capital reacts to changes in capital structure can be divided into three stages (Solomon ; 1969: 139).

First stage: Increasing value

The first stage begins with the initiation of debt in the total capital. In the beginning the cost of equity K_e remains constant or rises with debt and it does not increase fast enough to offset the advantage of low –cost debt. Here, the cost of debt, K_d , remains constant or rises

negligibly. Thus, the value of the firm, V , increases and the overall cost of capital declines with increasing leverage.

Under the assumption that K_e remains constant within the acceptable limit of debt the value of the firm will be:

$$V = S + D$$

Thus as long as K_e and K_d are constant the value of the firm, V , increases at a constant rate. $(K_e - K_d)/K_e$, as the amount of debt increases.

$$K_o = X/VK_e - (K_e - K_d)D/V$$

This implies that with $K_e > K_d$, the average cost of capital will decline with leverage.

Second Stage: Optimum Value

Once the firm has reached the certain degree of leverage, increase in leverage will have a negligible effect on the value or the cost of capital of the firm. This is so because the increase in the cost of equity due to the added financial risk exactly offsets the advantage of low cost debt.

Thus, within that range or at the specific point, the value of the firm will be maximum or the cost of capital will be minimum.

Third Stage: Declining Value

Beyond the acceptable limit of leverage, the value of the firm decreased with leverage or the cost of capital increases with leverage. This occurs because investors perceive a high degree of financial risk and demand a higher equity capitalization rate which offers the advantage of low cost debt.

The overall effect of above three stages is to imply that the cost of capital is a function of leverage. At first it declines with leverage and after entering a minimum level it starts rising. The relation between cost of capital and leverage is graphically shown in figure below, where the overall cost of capital curve, K_o , is saucer-shaped with a horizontal range. It indicates that there is a range of capital structures in which the cost of capital is minimized. K_e is assumed to increase slowly at first and then at a faster rate.

Iv. The Modigliani-Miller Approach (with out tax)

MM theory asserts that capital structure decision is irrelevant and there is no level of optimum capital structure. MM theory states that, in the absence of taxes the value and overall cost of capital is the expected net operating income divided by the total market value of the firm and it is equal to the capitalization rate of a pure equity

stream of its risk class. In their 1958 article (Pandey: 1999: 33), they provide analytical sound and logically consistent behavioral justification in favour of their hypothesis and reject any other capital structure theory as incorrect.

Assumptions of MM approach:

The MM approach can be best explained in terms of their propositions I and II. Their propositions based on certain assumptions, particularly related to the behavior of investors and capital market, the actions of the firm and the tax environment, can be described as (Pandey; 1999: 34)

- Securities are traded in the perfect capital market situation. This specifically means that: (a) investors are free to buy and sell securities (b) no restriction as the firms do and (c) they behave rationally and transaction costs do not exist.
- Firms can be grouped into homogeneous risk classes. It is generally implied that firms within same industry constitute a homogeneous class.
- The risk of investors is defined in terms of the variability of the net operating income.
- No corporate income taxes exist.
- Firms distribute all net earnings to the shareholders, i.e. 100% payout.

Proposition I

With given assumptions, MM argue that for the firms in the same risk class, the total market value is independent of the debt-equity mix and is given by capitalizing the expected net operating income by the rate appropriate to that risk class (Pandey;1999:34)

Proposition I can be defined as $V=S+D=X/KO=NOI/KO$

Where,

V = the market value of the firm

S = the market value of the firm's ordinary equity

D = the market value of debt

X = the expected net operating income on the assets of the firm

Ko = the capitalization rate appropriate to the risk class of the firm

The case be started in terms of the firm's average cost of capital.

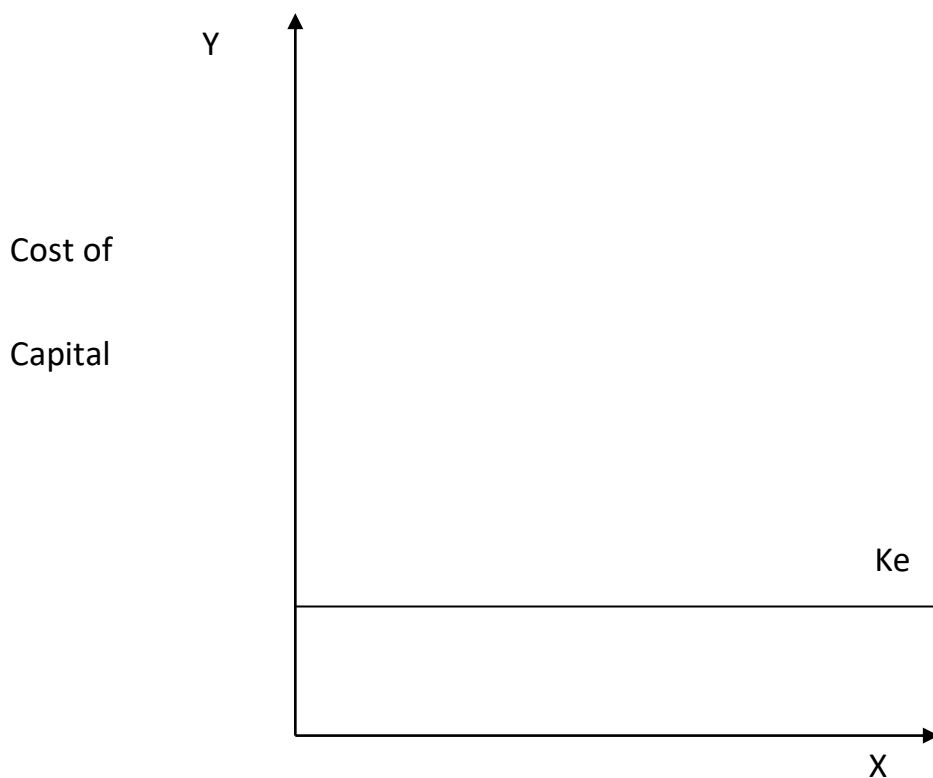
If Kd and Ke are defined as the expected return on the firm's debt and equity respectively, then, expected net operating income is:

$$X=KoV=KeS+KdD$$

Since MM conclude that the total market value of the firm is unaffected by the debt equity mix, it follows that the cost of capital is

completely independent of its capital structure and is equal to the capitalization rate. The cost of capital function, as hypothesized by MM is presented in the figure.

Fig 2.3: the cost of capital under MM hypothesis proposition I



Thus, two firms identical in all respects except to the capital structure have the same value and cost of capital. In this case, arbitrage will take place to enable investors to engage in personal leverage as against the corporate leverage to restore equilibrium in the market (Pandey, 1999:37)

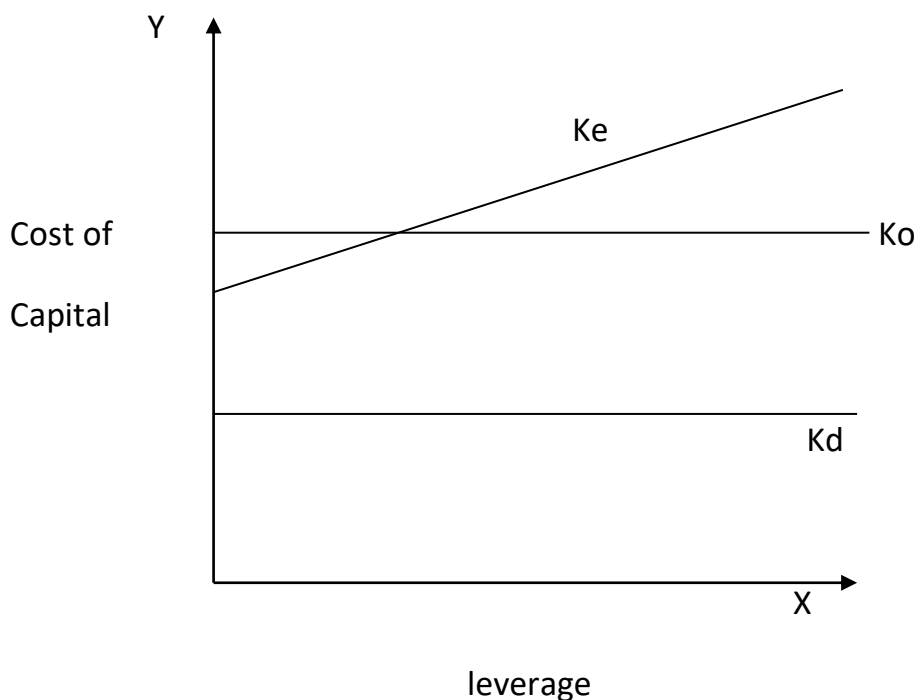
Proposition II

MM's proposition II, which defines the cost of equity, follows the proposition I. The expected field on equity can be defined as:

$$K_e = K_o + (K_o - K_d) D/S$$

The mm proposition could be valid, if K_d remains constant for any degree of leverage. But in practice K_d increases with leverage beyond the certain reasonable level of debt. However, MM maintains that even if K_d is increasing, K_o will remain constant. They argue when K_d will increase at a decreasing rate may even turn down eventually. This is shown in figure.

Fig. 2.4: the cost of equity under MM hypothesis proposition II



2.2. Review of journals and Articles

Weston's study (Weston ;1963:107), in "A test of cost of capital proposition," made some important-improvement in the cost of capital models. He included firm size and growth as additional explanatory in his model.

He found that the regression co-efficient of leverage to be positive and significant. However, when the multiple regressions were run, he found that the correlation coefficient is significant and the regression coefficient of leverage is negative and significant when the influence of growth is isolated leverage is found to be negative correlation with the cost of capital.

He concluded that the apparent lack of influence of leverage on the overall cost of capital observed by MM was due to the negative correlation of leverage with earning growth. Weston also listed MM preposition II.

Haim Bahadur Sharma (Sharma; 1968: 95) conducted a study "The capital structure and the cost of capital". In this paper, the firm's capital structure was examined in terms of two parameters: the expected rate of return on the firm's capital structure and the efficient opportunity curve of yield versus risk was presented, and the range of efficient capital structure of the firm was derived.

The capital structure theorem was formulated; starting that the firm's cost of capital is constant along the range of efficient capital structure and rise at the inefficient range. Since, the range of efficient capital structure of interest rates, it followed that the shape of the cost of capital curve is determined by

the interest rate and if it is constant, any capital structure is efficient and that the cost of capital is also constant.

Sharma and Rao (Sharma and Rao; 1969: 77) conducted the test of MM hypothesis on the influence of debt on the value of a firm to a non-regulated industry. They argued that estimate of cost of capital arrived at through this model will be accurate only when their hypothesis on debt and dividends are correct, this is an essential condition for the employment of this model. For the study purpose, they used samples of 30 engineering equation for three cross-section year: 1962, 1964 and 1965. Calculations of variables were done in exactly the same ways that done by MM with two exceptions. They experimented with total assets and sales for deflecting the variables and the results were meaningful when fixed of total assets were used as the deflector. They argued that when the growth rate of fixed assets was used as the growth variable, the results were somewhat inconsistent with the economic reasoning. They included that debt has non-tax advantage also. Thus, this paper support that the investors prefer corporate to personal leverage and therefore, the value of a firm rises up to leverage rate consider prudent.

Rao and Litznberges (Rao and litznberges; 1970:82) conducted a study on effect of capital structure in the cost of capital in less developed and less efficient capital market (India) and in a highly developed and efficient capital market (United State). They used 28 Indian utilities and 77 American utilities. They conducted the study for five cross-section years; 1962-1966. They found that the results for the American utilities are constant to the MM proposition that except for the advantages of debt financing, the cost of capital is independent of capital structure and the result also supported that

the MM hypothesis that investors are indifferent for the firm's dividend policy. In case of Indian utilities, the result are inconsistent to the MM approach and support the traditional belief, the judicious use of financial leverage will lower than the firm's cost of capital and investors have a preference for current dividends, in conclusions, they contended that the MM approach after allowing for the tax advantage of debt, the firm's cost of capital is independent of capital structure does not appear to be applicable in the case of developing economy.

Wipper (Wipper; 1990:60) conducted a study to test the empirical relationship between cost of capital and leverage. He tried to eliminate the principle problem of study on the leverage and attempted to offer what are hoped to be more fruitful alternatives in determining the relationship between leverage and cost of capital. He argued that the leverage either the ratio of debt to equity at book values, both of these measures contains important conceptual basis. He therefore used different measures of leverage, viz, $I/E=25$ where, I is the current level of fixed charges, E is the most recent year cash flow operating income determined from a logarithmic regression of income on time over ten years period, 25 is equal to two standard error around the regression line. He has assumed in the past investigation that homogeneity of business risk could be achieved by comparing firm in the same industry classification.

2.3. Thesis Review

M. K. Shrestha (1995) had conducted the study in "Analysis of capital structure in selected public enterprises, MBS thesis submitted to Tribhuvan

University". The main objective of the study is to analyze the capital structure of public enterprises. This study drew the conclusion that the selected public enterprises have a very confusing capital structure, since the corporations are not guided by objective-based financial plans and policies. Aphorism became the basis of capital structure in many cases, where most of them want to eliminate debt if possible to relieve financial obligations. He further added that many cases provide very fantastic results on the calculation of equity-capitalization rate according to given data through some cases carry valid and meaningful results. He discloses that performance of the Bank is satisfactory, liquidity is sufficient to meet depositor's claims, profitability is sufficient to meet interest on deposits and rate of return on share capital is favorable. However, the bank is explicitly depending more on borrowed fund and has a highly reared capital structure. The bank has to improve operational efficiency to achieve its higher profit goal and to maintain the market share under the intense competitive environment.

Youba Nath Pant (1996) had submitted a thesis on the topic of "A study on capital structure and assets structure of NIDC". The main objective of that study is to analyze capital structure and assets structure of NIDC finds that debt equity ratio and the total debt to equity ratio are very higher that leads the corporate risk. So, it should maintain the appropriate ratio of debt equity and total debt to equity by increasing share capital and decreasing the borrowing. Similarly, the total expenditure trend to any business. So, the corporation should pay the attention to maintain the expenditure of the corporation should pay the attention to maintain the expenditure of the corporation by reducing bonus and other office expenses. He suggests the

corporation maintains its liquidity ratio and investment, the total income will occur in increasing trend.

Keshar Jung Baral (1996) had submitted a thesis on the topic of “Capital structure and cost of capital in public sector enterprises of Nepal”. The main objective of that study is to analyze the capital structure and cost of capital in public sector enterprises of Nepal. That study reached to the conclusion that performance of public enterprises are very poor and they are not adding the wealth of the society but diluting it, and hindering the development of the country. Further, the huge amounts of adjusted losses of manufacturing and trading enterprises is quite below its cost of capital and overall cost of capital in almost fiscal years of the study period. Thus, it can be concluded that capital structure of enterprises in public sector in Nepal more or less is the outcome of the deliberate decision of Government but not a product of market and public enterprises structures.

Ganesh Prasad Neupane (1997) had conducted a thesis on “A study on the assets and capital structure of Nepal Bank Limited”. The study was made with the objective to analyze the assets and capital structure of Nepal Bank Limited finds that the amount of other assets is more than 3.5 times than the amount of net worth. It indicates that not only all the amount of net worth is used in unproductive assets but also other liabilities are used in fixed assets as land, furniture, stationery at hand. So, the total income of the bank could not increase along with the increasing rate of total liabilities.

Ramesh Raj Aryal (2001) had submitted a thesis study on “An evaluation of capital structure of Bottlers Nepal Limited”. Conclusion of that study was; all

the calculations show the bad performance of the company due to the inefficient capital structure management. The company is regarded as highly geared up capital structured company. Thus, to design suitable pattern of capital structure for the company, the management must bring about a satisfactory compromising among these conflicting factors of cost, risk, control and timing. He recommended that the company to shift debt capital to equity capital when the company have high earning per share.

Deepak Khanal (2002) had presented his thesis on the topic of “Capital structure management of industrial public enterprises”. Main objective of that study was to analyze the capital structure of industrial public enterprises. It was found that capital investment and earning were not correlated and most of public enterprises in loss position. Debt equity ratio was not satisfactory, financial performance of these companies were not good, so he suggested that management should reduced government subsidy and donation. They should improve their performance efficiency.

Rima Devi Shrestha (2003) had conducted a study on the topic of “Focus on capital structure (selected and listed companies)”. Her objective of that study was to analyze the capital structure of selected and listed companies. She used data from 19 companies and study had covered different sectors like manufacturing finance, utility service and other allied area. She had found that the most of these companies have debt capital relatively very higher than equity capital. Consequently, most of them are operating at losses to the extent that payment of interest on loan has serious issues.

Most of these losses are after charging interest on loan. She has suggested that the government has to consider public enterprises is that of evaluating the relationship between use of debt and its impact on overall earning of

public enterprises. So, government should be sure in knowing how using debt capital will minimize return. It should need to develop a suitable capital structure guideline to make public enterprises aware to the responsibility to repay the debt schedules. The other thing, which needs to be made publicity transparent that government money is not a lost less, found. Government has to analyze cost and risk return trade off. Thus, capital structure needs to be made more determinate by realistic analysis of cost.

R.L. Shrestha (2004) had conducted a thesis on the topic of capital adequacy of bank in Nepalese context". His main objective is to study the capital adequacy of bank. It has suggested that bank should deal in highly risk transaction to maintain strong capital base.

However, the capital base should neither be too much leading to inefficient allocation of scarce resources not too weak as to expose to extreme risk. The study accepts that the operations of bank and the degree of risk associated with are subject to change country-wise, bank-wise and product-wise. Henceforth, the study suggests preparing standard capital adequacy ratios for each individual bank keeping in mind the various relevant factors.

From the review of the studies conducted in different companies, it is transparent that the relationship between capital structure and cost of capital is almost non-existence. Thus, this study is conducted to analyze the capital structure of related banks (Nepal SBI Bank, Laxmi Bank and Everest Bank) with affecting that it will useful information for policy maker and the implementation of suggested findings.

Chapter - Three

Research Methodology

3.1. Introduction

Research in common parlance refers to a search for knowledge. The Webster international dictionary gives a very inclusive definition of research as a careful critical inquiry or examination in seeking facts & principles, diligent investigation in order to ascertain something (Saravanel : 1990:1).

Research Methodology is a way to systematically solve the research problem (Kothari; 1990:1). It may be understood as a science of studying how research is done scientifically.

This chapter looks into the research design, thesis procedure nature and sources of data, classification & tabulation of data, graphical presentation etc.

A research methodology helps us to find out accuracy, validity & suitability. The justification of present study cannot be obtained without help of proper research methodology. For achieving the objectives of study, the applied methodology will be used in the present study is briefly mentioned below.

3.2. Thesis procedure:

Thesis procedure is the series of steps that are taken for preparing the Thesis report . As per the standard systems this thesis procedure involved various activities in sequence. The first and foremost step in this procedure was

selection of the topic for the thesis report., next important task was the selection of the commercial banks of which the report would be prepared and I preferred Nepal SBI Bank Ltd , Laxmi Bank Ltd & Everest Bank Ltd. Collection of data information and statistics was another step which followed thereafter . Consulting teachers, references materials and processing of information were also done by me. Submission of proposal was another major task. The presentation of the output of the analysis in the form of this thesis report was the last step involved in this procedure.

3.3. Research Design:

Research design is a plan structure & strategy of investigation conceived so as to questions and control variance. The analysis of this study based on certain research design keeping in mind on the objectives of the study . Generally, research design means definite procedure and techniques which guides in studying profound ways of research viability. The main objectives of the study are to analysis the capital structure of listed commercial bank in Nepal i.e. on a case study of Nepal SBI Bank Ltd, & Everest Bank Ltd. It emphasizes on descriptive and analytical study of the collected data from profit & loss account and balance sheet (i.e. financial statement) over a period of time as well as personal & telephone interviews. Analysis with different statistical & financial tools has been conducted to find out the necessary result also. Research design presents a series of guide posts to enable the researchers to progress in right direction in order to achieve the goals.

3.4. Sources of data:

The main sources of data are secondary extracted from the annual report published by banks & publication of NRB .Balance sheet and profit & loss account of last five years are taken for the secondary means. At times of necessity the primary sources of information are collected through discussion and enquiries made from concerned bank.

3.5. Methods of analysis and presentation of data :

In this study, the basic secondary data extracted from the annual report have been processed, tabulated, analysed and interpreted considering the requirement of the management. I basically used the secondary data, which are first analysed and tabulated into a separate form statistically. A different financial and statistical tool has been used to find out the structure & profitability position of the forms.

3.6. Financial tools :

Capital structure ratio and some other majors ratio are used in this study.

The capital structure ratio is defined as financial ratios which throw light on the long- term solvency of a firm as reflected in its ability to assure the long – term creditors with regard to periodic payment of interest during the period of the loan and repayment of principle of maturity.

The major ratios used in this research are:

a) Leverage

- i. Degree of operating leverage
- ii. Degree of financial leverage
- iii. Degree of combined leverage

b) Capital structure / leverage / solvency ratio

- i. Debt equity ratio
- ii. Debt to assets ratio
- iii. Interest coverage / time interest earned / debt service ratio
/ Debt competency ratio
- iv. Capital Sufficiency Ratio / Capital Adequacy Ratio

Statements of hypothesis:

The following hypothesis is formulated and tested of capital structure of commercial banks in Nepal.

Null hypothesis (H₀) : There is insignificant difference between mean value of debt & equity capital of commercial banks in Nepal

Alternative hypothesis (H₁) : There is significant difference between mean value of debt & equity capital of Commercial banks in Nepal.

Chapter - Four

Presentation and Analysis of data

4.1. Introduction

This chapter named Presentation and Analysis of data constitute the most crucial part of the study. It provides a mechanism for meeting the basic objectives stated earlier in the first chapter of this research. The research has followed the methodology described in the third chapter in order to attain the objectives. The objectives of this study and chapter as a whole are to examine the capital structure of Nepal SBI Bank Ltd., Laxmi Bank Ltd., and Everest Bank Ltd. Different types of analytical tools and techniques have been used to analyse the data and derive certain findings.

The firm should maintain a sound capital structure to run its business operation in this competitive world. Both excessive as well as inadequate capital positions are unhealthy from the firm's point of view. So an enlightened management should therefore maintain right capital structure to meet its objective.

The data used for the analysis are Profit and Loss Account, Balance Sheet, Ownership's equity, deposits, main index, etc. These data are based on annual report. Descriptive analysis is used to analyze the sources of capital. Other tools are used for analysis are the tools of leverage as DOL, DFL, and DCL. Tools concerning ratio analysis are also calculated for checking long term solvency.

4.2. Descriptive analysis of Ratio

This section of the study explores the capital structure with respect to the capital, reserves, deposits, current liability and borrowing. The table below shows the paid-up capital, Reserves, Borrowing and deposits of above mentioned banks for the year 2066/67 B.S (2009/2010 A.D).

Table 4.1: Paid up capital, Reserves, Borrowings & Deposits of NSBL, LBL and EBL for the year 2066/67

(Rs.'000')

	Paid up	Reserves	Borrowing	Deposits
NSBL	1861324	589230	200000	34896424
Laxmi Bank	1614000	298809	100000	18083000
Everest Bank	1030467	1479530	404600	36932310

1. Share capital trend

Share capital is the fully paid up or issued capital of the concerned bank. The table that follows the deposits of the share capital trend of the commercial banks for five consecutive fiscal year.

Table 4.2: Share capital trend of NSBL

(in 000)

Year	Paid up capital	Index trend	Yearly change
2062/63	640236	100%	-
2063/64	647798	101%	1.1%
2064/65	874528	136%	35%
2065/66	1224339	191%	55%
2066/67	1861324	290%	99%

Source: Annual report of Nepal SBI Bank

Fig 4.1: Share capital trend of NSBL

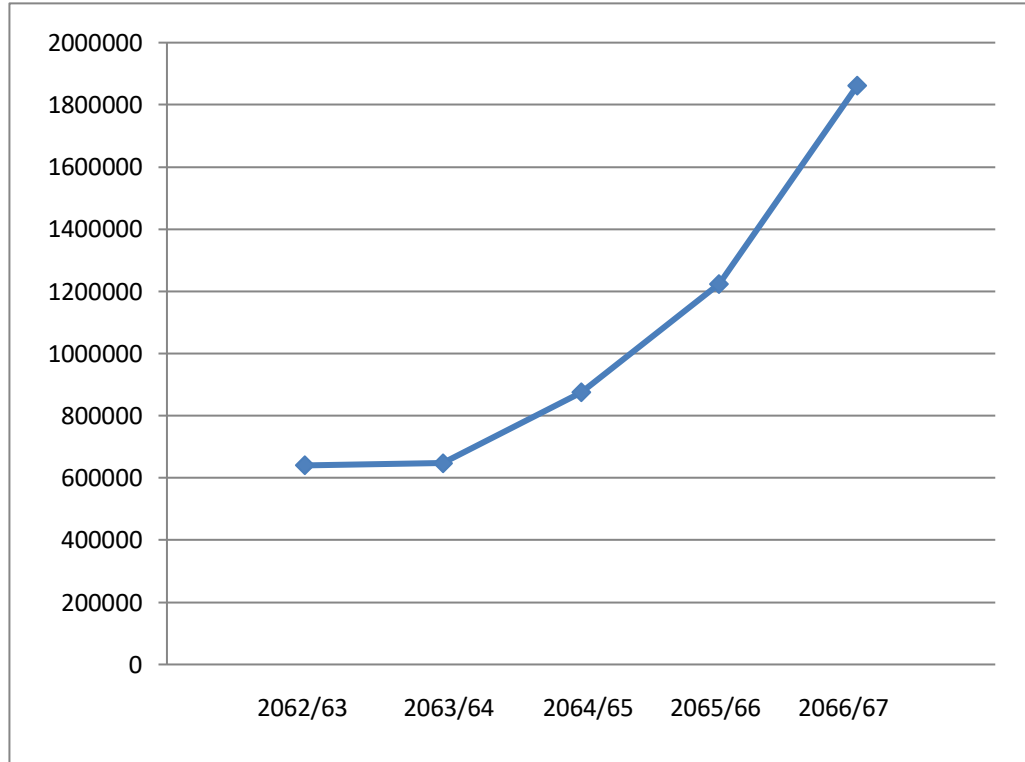


Table 4.3: Share capital trend of Laxmi Bank Ltd.

(in 000)

Year	Paid up capital	Index trend	Yearly change
2062/63	609917	100%	-
2063/64	729697	119%	19%
2064/65	913000	149%	30%
2065/66	1098000	180%	31%
2066/67	1614000	265%	85%

Source: Annual report of Laxmi Bank Ltd

Fig 4.2: Share capital trend of Laxmi Bank Ltd.

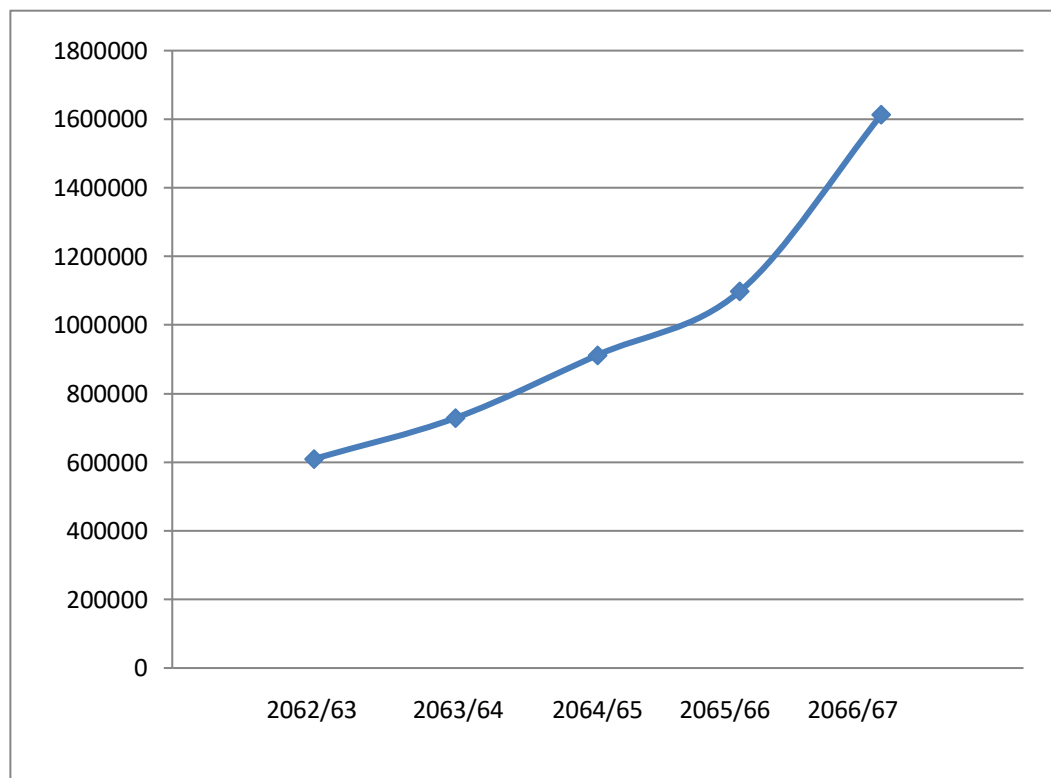


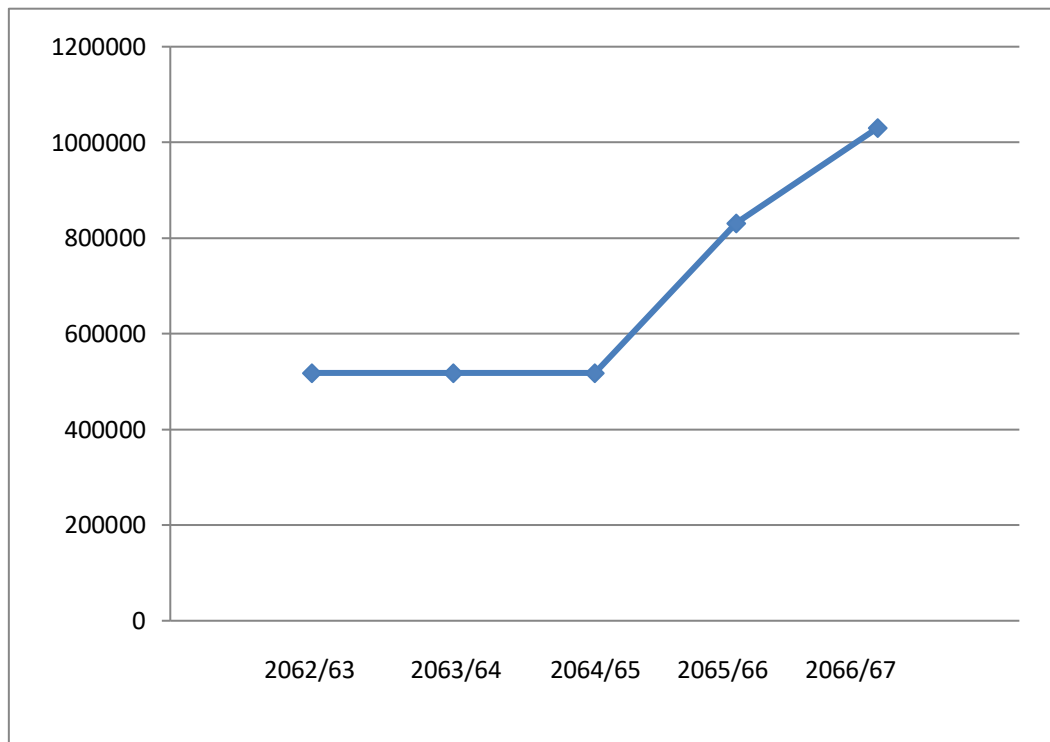
Table 4.4: Share capital trend of Everest Bank Ltd.

(in 000)

Year	Paid up capital	Index trend	Yearly change
2062/63	518000	100%	-
2063/64	518000	100%	-
2064/65	518000	100%	-
2065/66	831400	161%	61%
2066/67	1030467	199%	38%

Source: Annual report of Everest Bank Ltd

Fig. 4.3: Share capital trend of Everest Bank



2. Reserves and surplus trend of commercial Bank

It refers to the total capital of the concerned bank and includes general reserve , share premium and other reserves. The following table shows the reserve and surplus of the mentioned bank for 5 consecutive years.

Table 4.5: R/S Trend of NSBL

(in 000)

Year	R/S	Index trend	Yearly change
2062/63	342138	100%	-
2063/64	515492	151%	51%
2064/65	540117	158%	7%
2065/66	488268	143%	-15%
2066/67	589230	172%	29%

Source: Annual report of NSBL

Fig. 4.4: R/S trend of NSBL

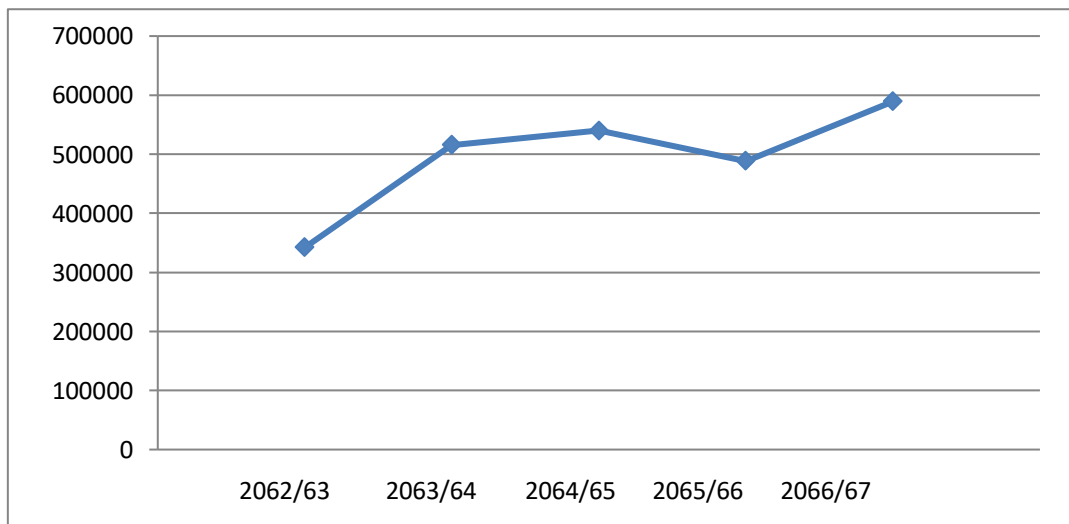


Table 4.6: R/S Trend of Laxmi Bank

(in 000)

Year	R/S	Index trend	Yearly change
2062/63	69116	100%	-
2063/64	134696	195%	95%
2064/65	913196	1321%	1126%
2065/66	1098086	1589%	268%
2066/67	298809	432%	1157%

Source: Annual report of Laxmi Bank Ltd

Fig. 4.5: R/S trend of Laxmi Bank

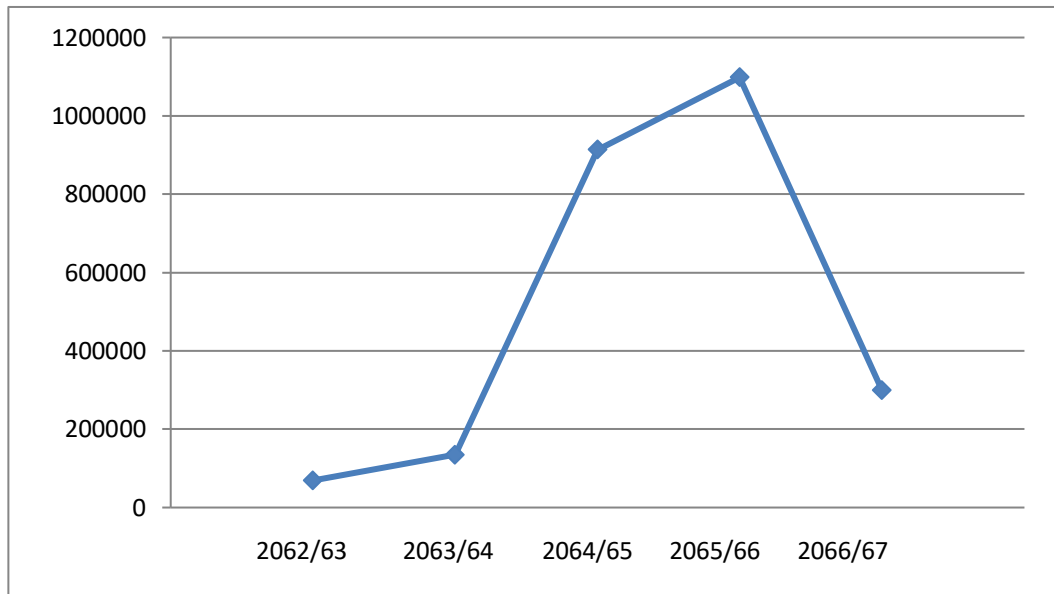


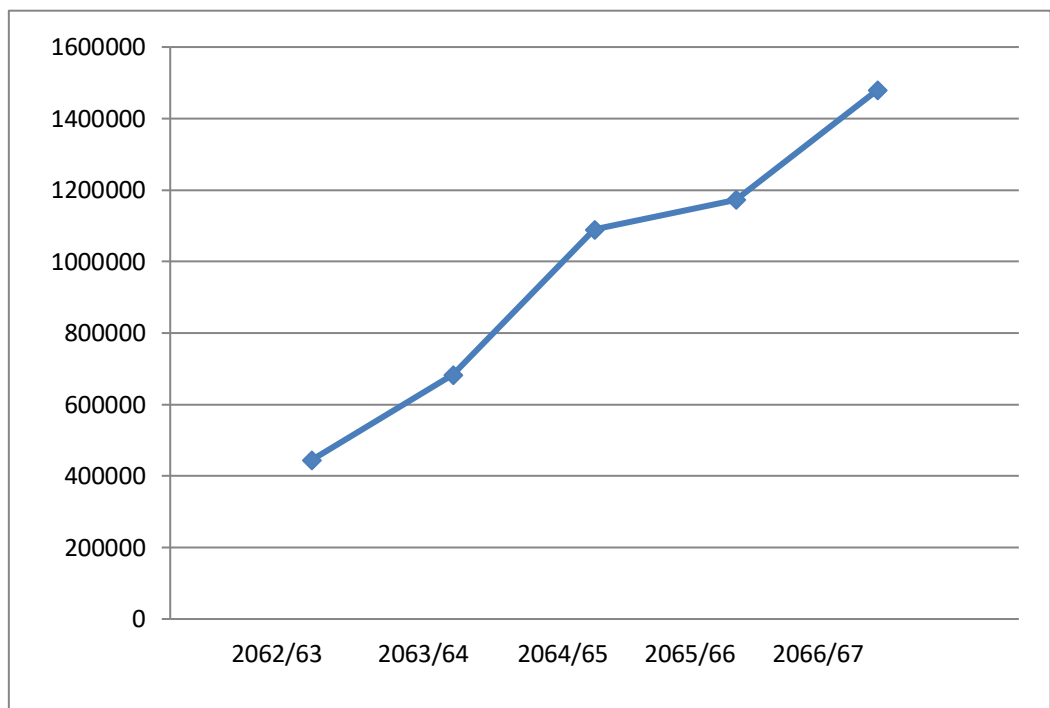
Table 4.7: R/S Trend of Everest Bank

(in 000)

Year	R/S	Index trend	Yearly change
2062/63	444808	100%	-
2063/64	683515	154%	54%
2064/65	1089837	245%	91%
2065/66	1173157	264%	19%
2066/67	1479530	333%	69%

Source: Annual report of Everest Bank Ltd

Fig. 4.6: R/S trend of Everest Bank



3. Borrowing Trend

It is an amount taken by the commercial bank from different lenders. It includes both the local and foreign borrowing.

Borrowing trend of the commercial bank is shown in the table placed below:

Table 4.8: Borrowing Trend of NSBL

(in 000)

Year	Borrowing	Index trend	Yearly change
2062/63	812429	100%	-
2063/64	1015365	125%	25%
2064/65	1827480	225%	100%
2065/66	200000	25%	-200%
2066/67	200000	25%	0%

Source: Annual report of NSBL

Fig. 4.7: Borrowing trend of NSBL

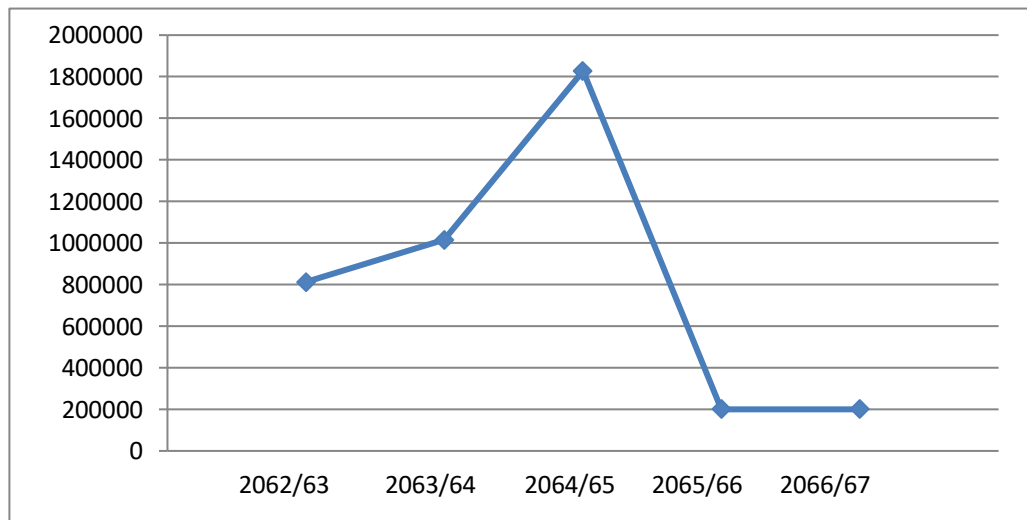


Table 4.9: Borrowing Trend of Laxmi Bank Ltd

(in 000)

Year	Borrowing	Index trend	Yearly change
2062/63	29760	100%	-
2063/64	-	-	-
2064/65	300000	1000%	900%
2065/66	450000	1512%	412%
2066/67	100000	336%	-1176%

Source: Annual report of Laxmi Bank

Fig. 4.8: Borrowing trend of Laxmi Bank

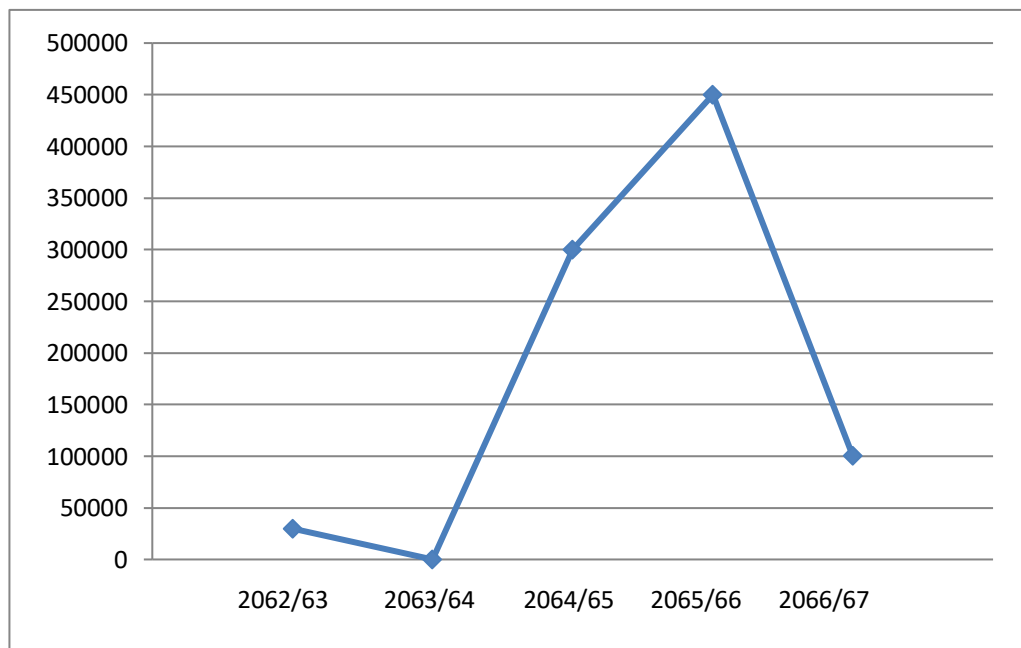


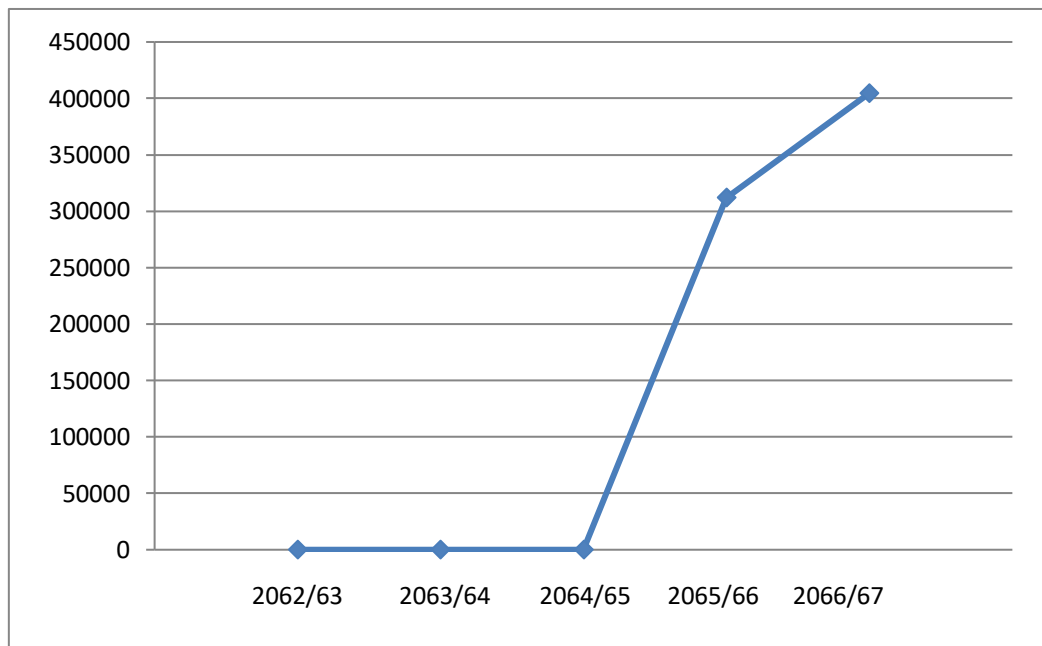
Table 4.10: Borrowing Trend of Everest Bank Ltd

(in 000)

Year	Borrowing	Index trend	Yearly change
2062/63	-	-	-
2063/64	-	-	-
2064/65	-	-	-
2065/66	312000	100%	-
2066/67	404600	129%	29%

Source: Annual report of Everest Bank

Fig. 4.9: Borrowing trend of Everest Bank



4. Deposit Trend

Deposit refers to the money collected in the bank having an account as current, saving and fixed deposits of the commercial banks.

The table below shows the deposit trend of the sample banks.

Table 4.11: Deposit Trend of NSBL

(in 000)

Year	Deposits	Index trend	Yearly change
2062/63	11002041	100%	-
2063/64	11445286	104%	4%
2064/65	13715395	125%	29%
2065/66	27957221	254%	129%
2066/67	34896424	317%	63%

Source: Annual report of Nepal SBI Bank Ltd

Fig. 4.10: Deposit trend of Nepal SBI Bank

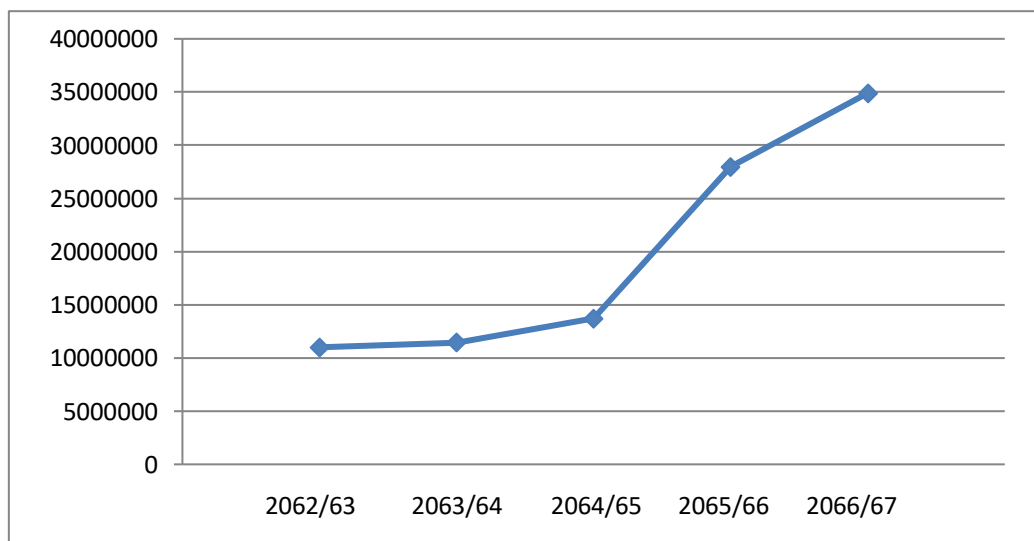


Table 4.12: Deposit Trend of Laxmi Bank Ltd.

(in 000)

Year	Deposits	Index trend	Yearly change
2062/63	4444351	100%	-
2063/64	7611653	171%	71%
2064/65	10917000	245%	74%
2065/66	16051300	361%	116%
2066/67	18083000	406%	45%

Source: Annual report of Laxmi Bank Ltd

Fig. 4.11: Deposit trend of Laxmi Bank

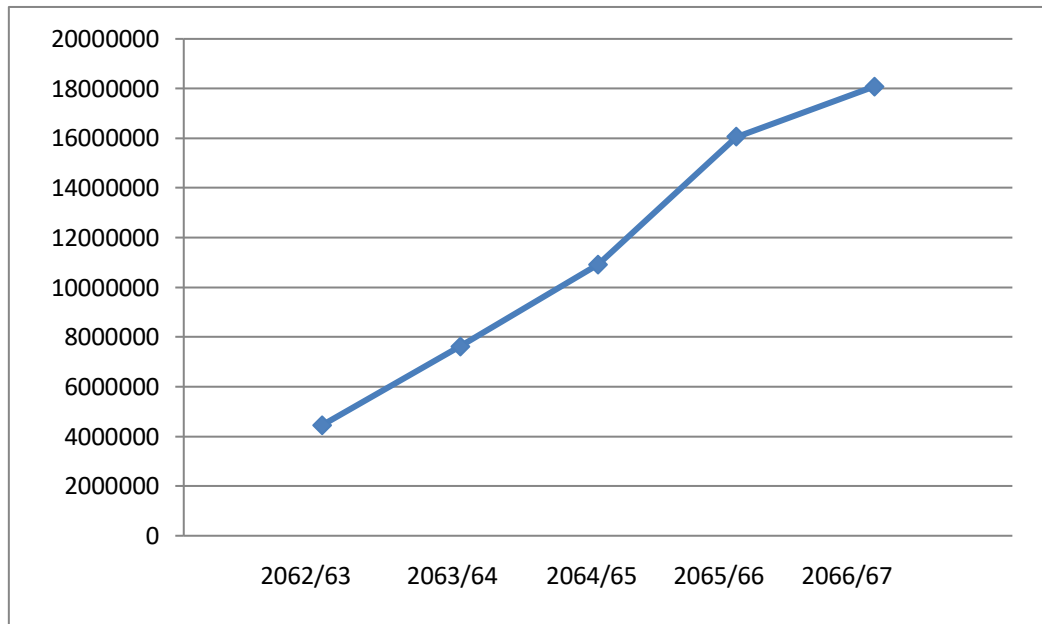


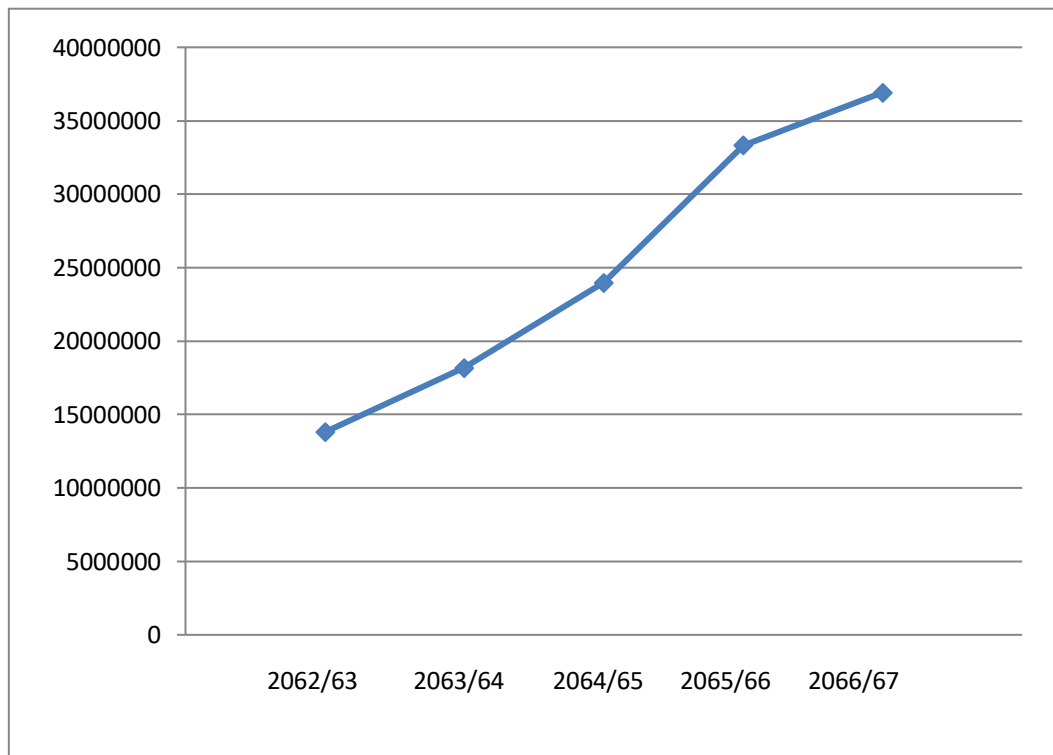
Table 4.13: Deposit Trend of Everest Bank Ltd.

(in 000)

Year	Deposits	Index trend	Yearly change
2062/63	13802445	100%	-
2063/64	18186254	132%	32%
2064/65	23976298	174%	42%
2065/66	33322946	241%	67%
2066/67	36932310	268%	27%

Source: Annual report of Everest Bank Ltd

Fig. 4.12: Deposit trend of Everest Bank



5. Total Liabilities Trend

It is the total capital of commercial banks. It includes share capital (paid-up), R/S, Deposits, current liabilities of the sample bank. Total liabilities trend of the commercial bank has been shown below in the table for five consecutive fiscal year.

Table 4.14: Total Liabilities trend of NSBL

(in 000)

Year	Total Liabilities	Index trend	Year change
2062/63	13035839	100%	-
2063/64	13901201	107%	7%
2064/65	17187446	132%	25%
2065/66	30916644	237%	105%
2066/67	38047679	292%	55%

Source: Annual report of NSBL

Fig. 4.13: Total liabilities trend of NSBL

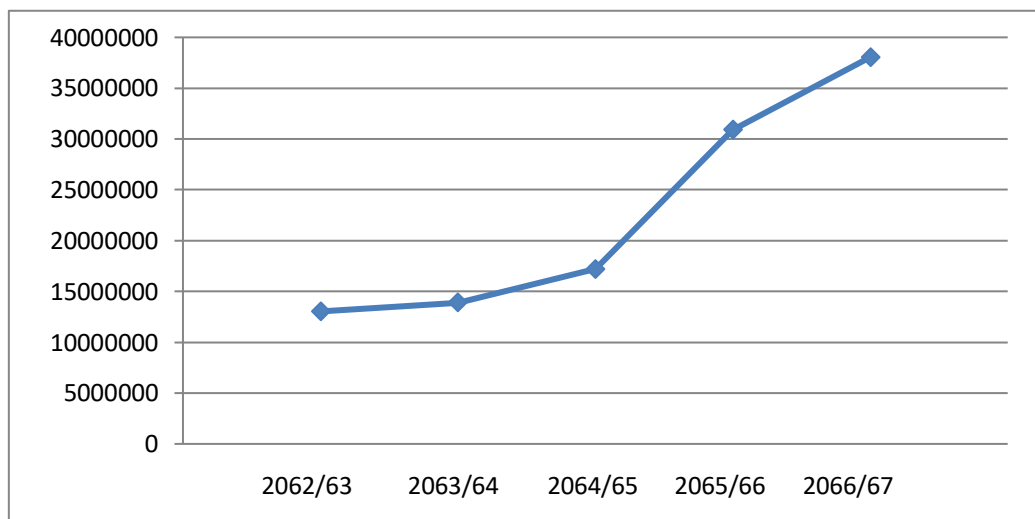


Table 4.15: Total Liabilities trend of Laxmi Bank Ltd

(in 000)

Year	Total Liabilities	Index trend	Year change
2062/63	5205190	100%	-
2063/64	8582689	65%	65%
2064/65	1269500	24%	-141%
2065/66	18386413	353%	329%
2066/67	20952249	402%	49%

Source: Annual report of Laxmi Bank Ltd

Fig. 4.14: Total liabilities trend of Laxmi Bank

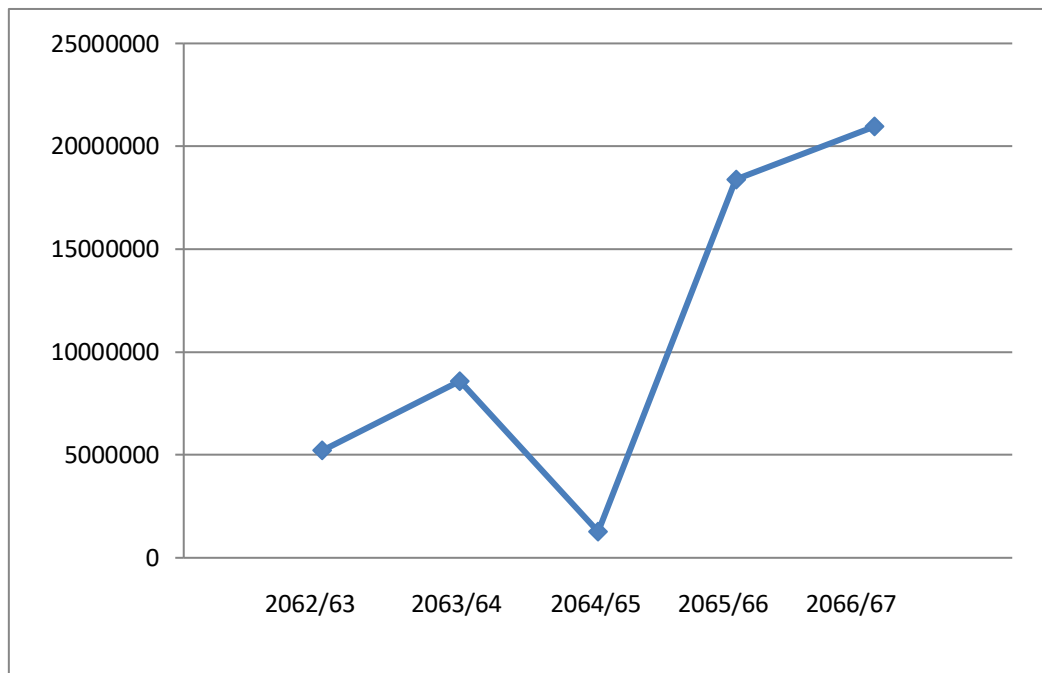


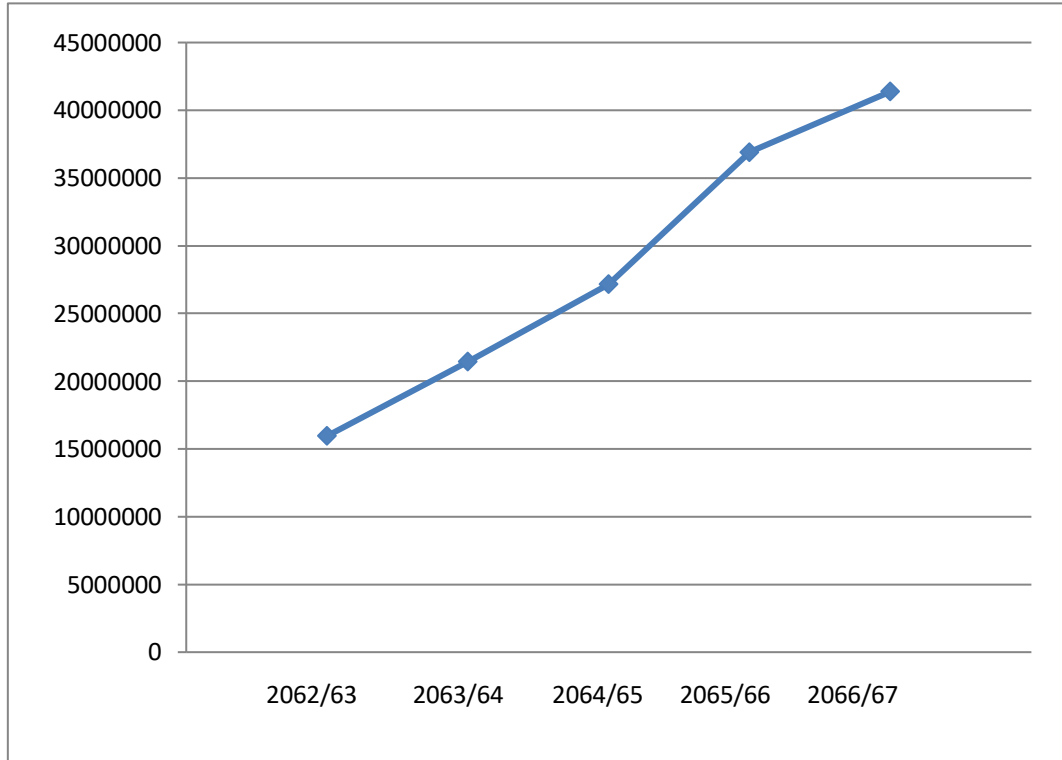
Table 4.16: Total Liabilities trend of Everest Bank Ltd.

(in 000)

Year	Total Liabilities	Index trend	Year change
2062/63	15959285	100%	-
2063/64	21432574	134%	34%
2064/65	27149343	170%	36%
2065/66	36916849	231%	61%
2066/67	41382761	259%	28%

Source: Annual report of Everest Bank Ltd.

Fig. 4.15: Total liabilities trend of Everest Bank



6. Leverage

Leverage tools prove to be best acquired and managed study of leverage helps to maintain good capital structure. Leverage helps to analyze the effect of capital collection from certain sources to decide the composition of capital structure. It guides to the optimum use of debt capital with a low interest rate as possible thereby increasing the profit of shareholders.

James and Waller-“Leverage may be defined as percentage return on equity to percentage return on total capitalization.”

Lawrence J. Gitman- “The term leverage is quite commonly used to describe the firm’s ability to use fixed cost assets or funds to magnify the return on its owners.”

From above we may conclude that a practice of using debt capital at low interest rate thereby increasing equity holder’s rate of return is leverage. It helps for choosing best alternative for capital collection.

Leverage can be classified into three categories.

6.1 Degree of operating leverage (DOL):

DOL of a particular level of output (sales or income) is simply the % change in operating profit over the %change in the output that causes the change in profit.

$$DOL = \frac{\% \text{ change in EBIT}}{\% \text{ change in sales or income}}$$

6.2 Degree of financial leverage (DFL):

The debt at a particular level of operating profit is simply the % change in EPS over the % change in operating profit that causes the change in EPS.

$$DOL = \frac{\% \text{ change in EPS}}{\% \text{ change in EBIT}}$$

OR,

$$DFL = \frac{EBIT}{EBIT - I - Pd/1 - t}$$

Hence, there is no pref. dividend (Pd)

Therefore,

$$DFL = \frac{EBIT}{EBT}$$

6.3 Degree of combined leverage:

When financial leverage is combined with operating leverage the result is referred to as total or combined leverage.

$$DCL = \frac{\% \text{ change in EPS}}{\% \text{ change in EBIT}}$$

OR,

$$DCL = DOL \times DFL$$

Table 4.17: Calculation of DOL, DFL and DCL of NSBL

(In 000)

Year	C/M	EBIT	EBT	DOL	DFL	DCL
062/63	799670	700456	199765	1.14	3.50	3.99
063/64	945774	825661	344590	1.15	2.39	2.75
064/65	1092977	940597	348034	1.16	2.70	3.13
065/66	1653367	1429401	443032	1.16	3.23	3.75
066/67	2550521	2206671	538362	1.16	4.09	4.74

Sources: Annual report of NSBL.

Fig. 4.16: Calculation of C/M, EBIT and EBT of NSBL

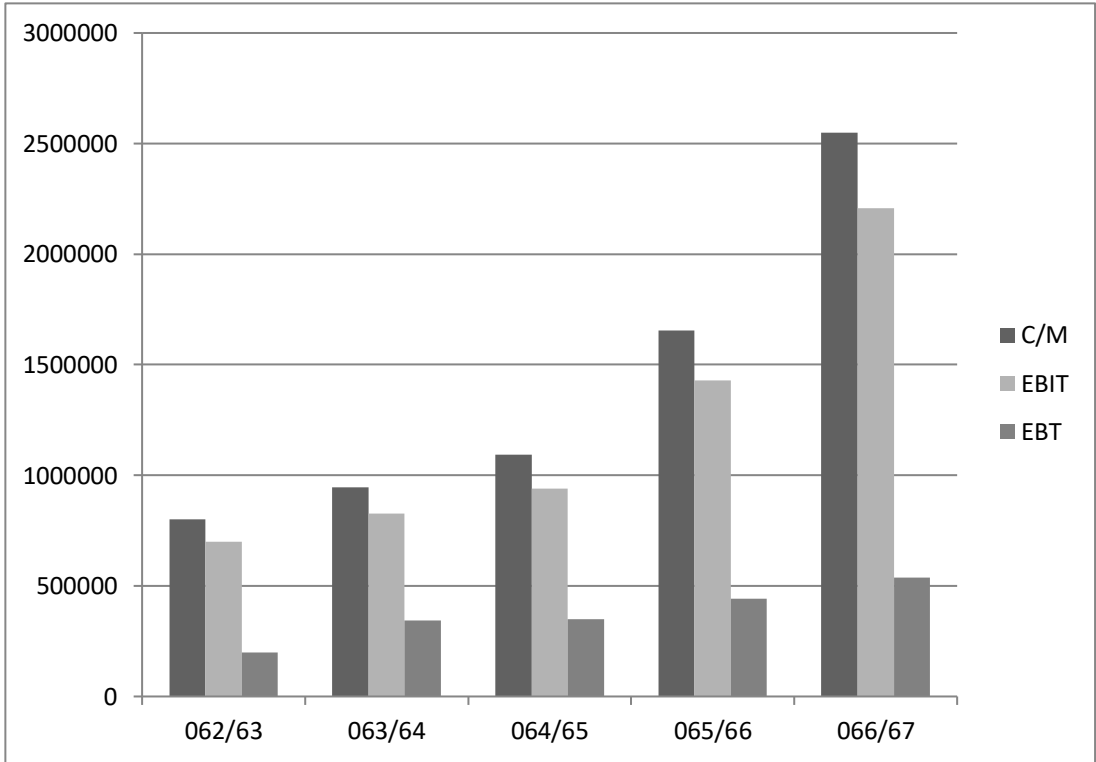


Table 4.18: Calculation of DOL, DFL and DCL of Laxmi Bank Ltd.

(In 000)

Year	C/M	EBIT	EBT	DOL	DFL	DCL
062/63	353507	247015	56425	1.43	4.38	6.26
063/64	522267	389783	109505	1.33	3.56	4.73
064/65	804068	640592	218720	1.26	2.93	3.69
065/66	1250540	1051160	338812	1.19	3.10	3.69
066/67	1942153	1677578	541968	1.16	3.09	3.58

Sources: Annual report of Laxmi Bank Ltd

Fig. 4.17: Calculation of C/M, EBIT and EBT of Laxmi Bank

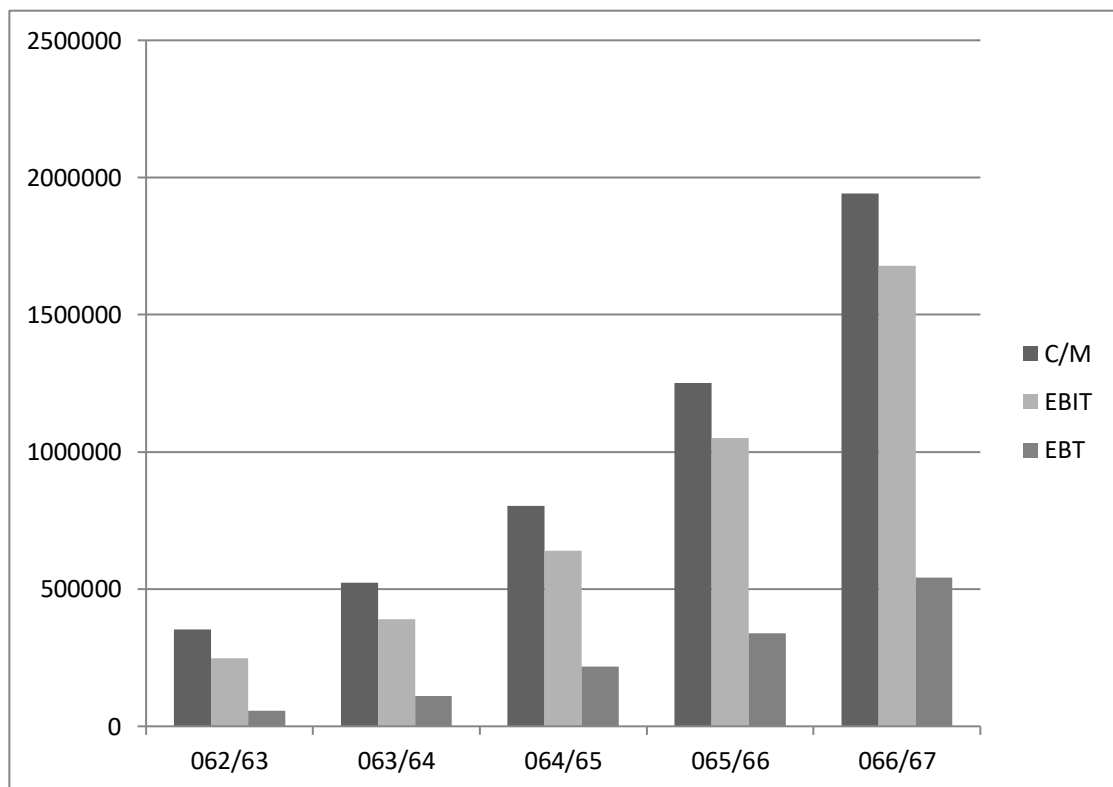


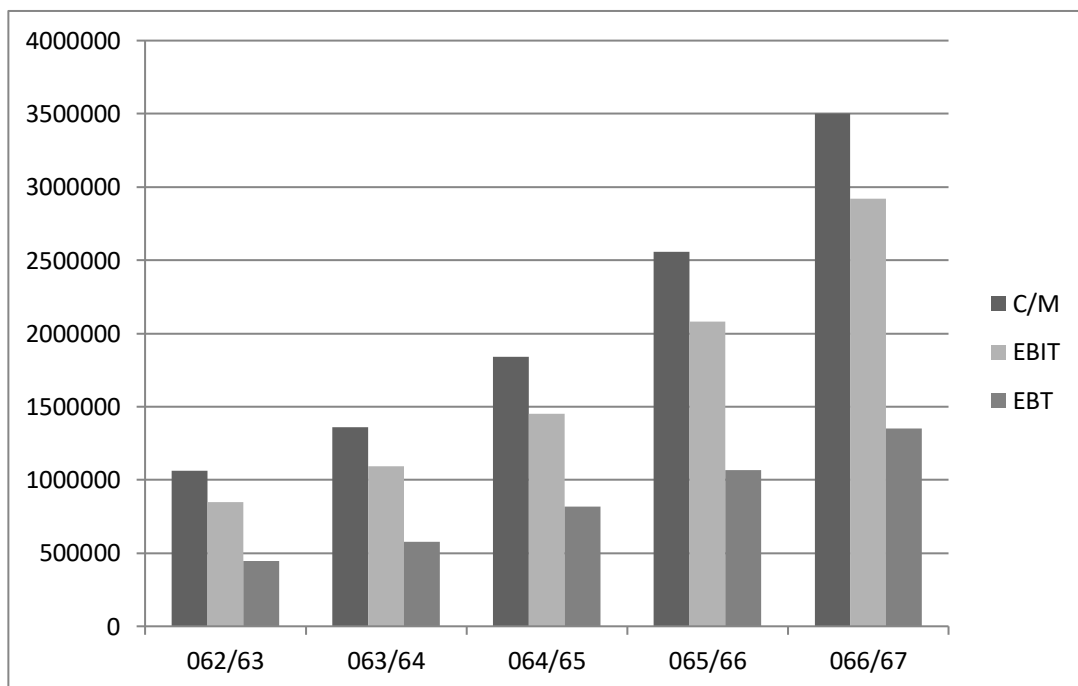
Table 4.19: Calculation of DOL, DFL and DCL of Everest Bank Ltd

(In 000)

Year	C/M	EBIT	EBT	DOL	DFL	DCL
062/63	1063550	849063	447666	1.25	1.89	2.36
063/64	1358499	1094835	577669	1.24	1.90	2.35
064/65	1842522	1450798	818189	1.27	1.77	2.25
065/66	2557839	2078910	1066036	1.23	1.95	2.39
066/67	3500764	2921889	1349099	1.19	2.17	2.58

Sources: Annual report of Everest Bank Ltd.

Fig. 4.18: Calculation of C/M, EBIT and EBT of Everest Bank



DOL, DFL, and DCL must be above 1. The result below 1 shows that the capital structure is not suitable and cannot earn as the firm should have.

According to DOL the result is positive because DOL of above bank of each year is above 1. However the trend is fluctuating.

According to DFL also the result is above 1. It suggests the use of debt capital is maximum. If the result is equal to 1, it means the firm has not used debt capital. The trend of DFL in the five consecutive years is decreasing.

According to DCL, the results seems satisfying. It shows the change in EPS with 1% change in sales or income. However the result is decreasing.

7. Capital structure/Leverage/Solvency ratio

Leverage ratio analysis is the long term solvency of the firm. Solvency is the Bank's ability to pay its debt when they become due. This ratio also shows the manner by which the capital structure is formed. That is why it is called capital structure ratio.

Leverage ratio includes:

- Debt equity ratio
- Debt to total assets ratio
- Interest coverage ratio/time interest Earned/Debt competence ratio
- Capital Sufficiency/Capital adequacy ratio

7.1 Debt Equity Ratio

Debt equity ratio indicates the extent to which debt financing is used relative to equity financing. Debt equity ratio is a very vital tool used to analyze the long term solvency of a firm. Here the debt can be defined as total debt or as long as long term debt. Long term creditors generally prefer to see a modest debt equity ratio since it means greater protection and a greater stake in company's future for equity holders. Total debt includes current accounts saving accounts, calls and short deposits, overdrafts, fixed deposits, loan and advance borrowing from other banks. Shareholders equity or net worth includes paid-up capital reserve and surplus. It is computed as:

$$\text{Debt Equity Ratio} = \frac{\text{Total Debt}}{\text{Shareholder's equity}}$$

7.2. Debt to assets ratio:

Debt to assets ratio shows what portions of the capital assets are financed by outside funds. When successfully employed this ratio benefits the shareholders by raising their expected return earning per share. A high ratio shows Bank's success in exploiting debt to be more profitable as well as it also indicates that it is riskier capital structure and vice-versa. It is computed as :

$$\text{Debt of assets ratio} = \frac{\text{Total Debt}}{\text{Total Assets}} \times 100\%$$

Table 4.20: Calculation of Debt/Equity Ratio and Debt Assets ratio of NSBL

Year	Total Debt	Total Equity	Total Assets	Debt/Equity Ratio	Debt Assets Ratio
062/63	12053466	982374	13035839	12.27	92.41%
063/64	12737909	1163291	13901201	10.95	91.65%
064/65	18274800	1414645	17187446	12.92	106.33%
065/66	200000000	1712607	309166440	116.78	64.69%
066/67	200000000	2450554	380476790	81.61	52.56%

Source: Annual report of NSBL

Fig. 4.19: Total Debt and Total Equity of NSBL

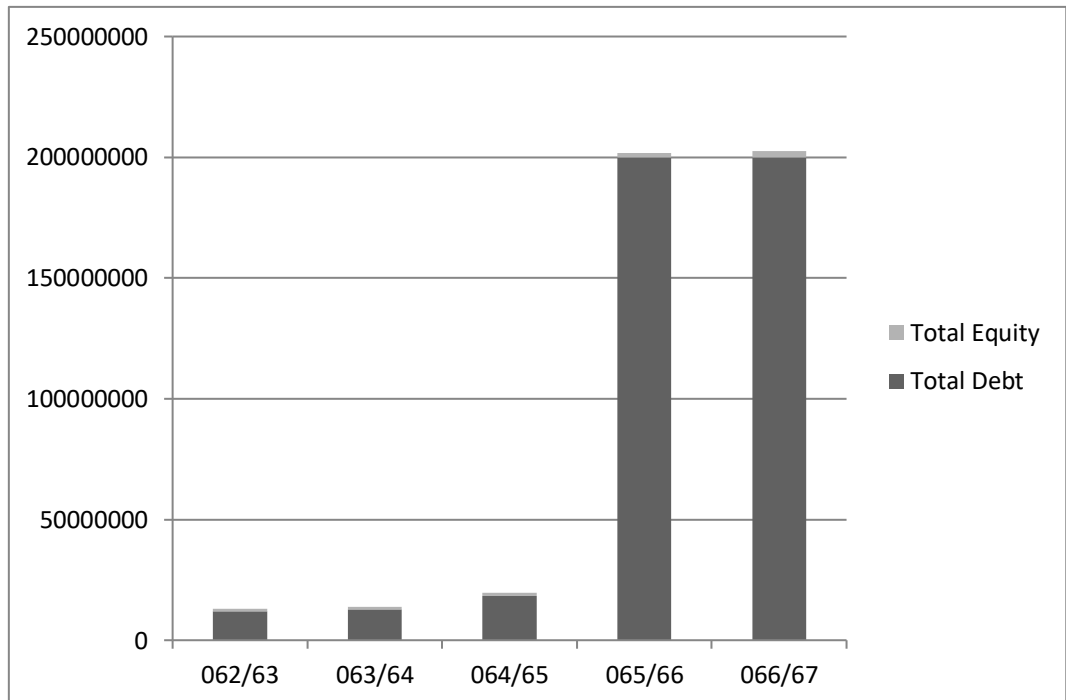


Table 4.21: Calculation of Debt/Equity Ratio and Debt Assets ratio of Laxmi Bank

Year	Total Debt	Total Equity	Total Assets	Debt/Equity Ratio	Debt Assets Ratio
062/63	4526156	679033	5205190	6.67	86.95%
063/64	7718295	864393	8582689	8.93	89.93%
064/65	350000	1065975	12695000	0.32	2.76%
065/66	800000	1343219	18386412	0.59	4.35%
066/67	450000	1912330	20952249	0.23	2.15%

Source: Annual report of Laxmi Bank

Fig. 4.20: Total Debt and Total Equity of Laxmi Bank

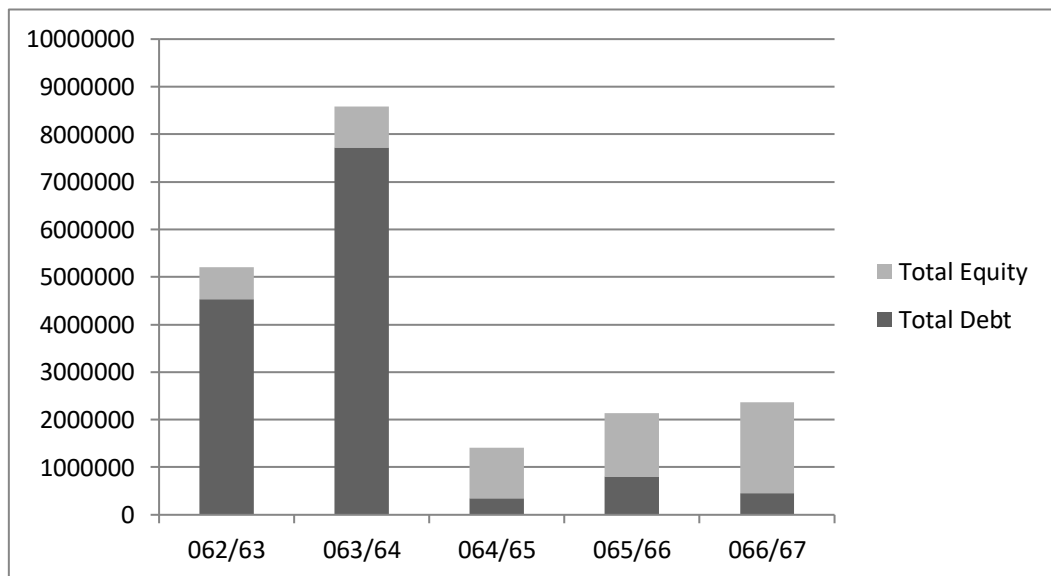
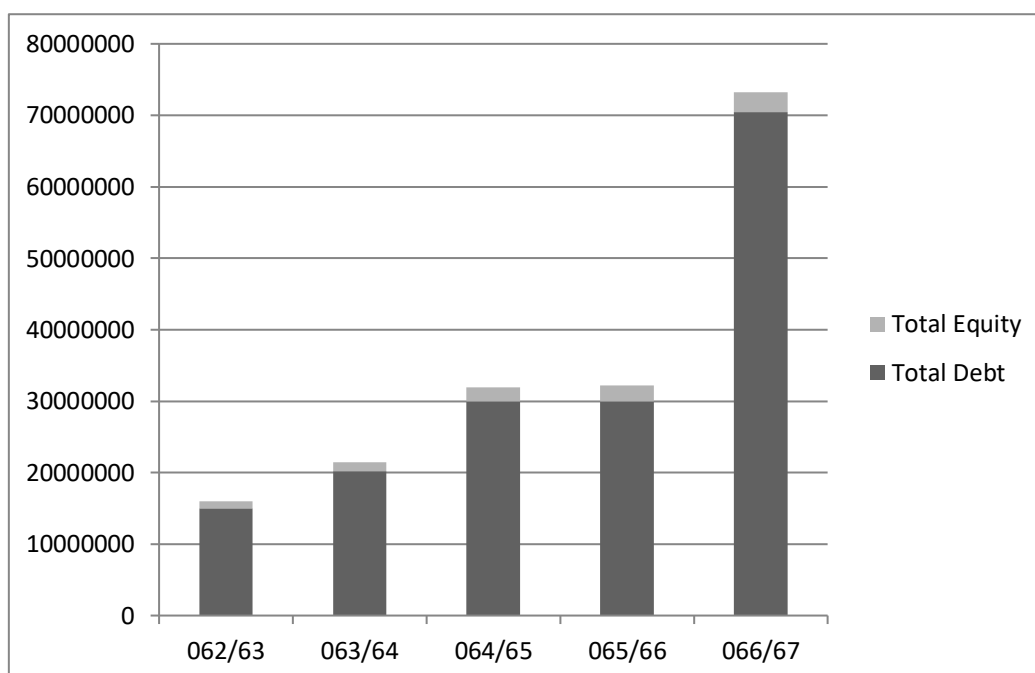


Table 4.22: Calculation of Debt/Equity Ratio and Debt Assets ratio of Everest Bank

Year	Total Debt	Total Equity	Total Assets	Debt/Equity Ratio	Debt Assets Ratio
062/63	14996477	962808	15959285	15.57	93.96%
063/64	20231059	1201515	21432574	16.83	94.39%
064/65	30000000	1921200	21432574	15.62	139.97%
065/66	30000000	2203600	27149343	13.61	110.49%
066/67	70460000	2759100	41382761	25.54	170%

Source: Annual report of Everest Bank

Fig. 4.21: Total Debt and Total Equity of Everest Bank



7.3. Interest coverage/time interest earned/debt competence ratio:

The interest coverage ratio also named as the time interest earned ratio is designed to relate the financial changes of a firm to its ability to service to cover them. Interest coverage ratio reflects the firm's ability to pay interest out of earnings. This ratio is simply the ratio of earnings before interest and tax (EBIT) for particular reporting period to the amount of interest charges for the period. Too high or too low ratio is unfavorable to the banks. Too high ratio implies unused debt capacity at a firm's conservativeness in using debt to its best advantage. Whereas low ratio imply a danger signal that the firm is using excessive debt and does not have the ability to offer assured payment of interest to the creditors.

$$\text{Interest coverage ratio} = \frac{\text{EBIT}}{\text{Interest Expenses}}$$

Table 4.23: Computation of interest coverage Ratio of Nepal SBI Bank Ltd.

(in 000)

Year	EBIT	Interest	TIE Ratio
062/63	700456	334770	2.09
063/64	825661	412262	2.03
064/65	940597	454918	2.07
065/66	1429401	824700	1.73
066/67	2206671	1443694	1.53

Source: Annual report of NSBL

Fig. 4.22: EBIT and Interest of Nepal SBI Bank Ltd.

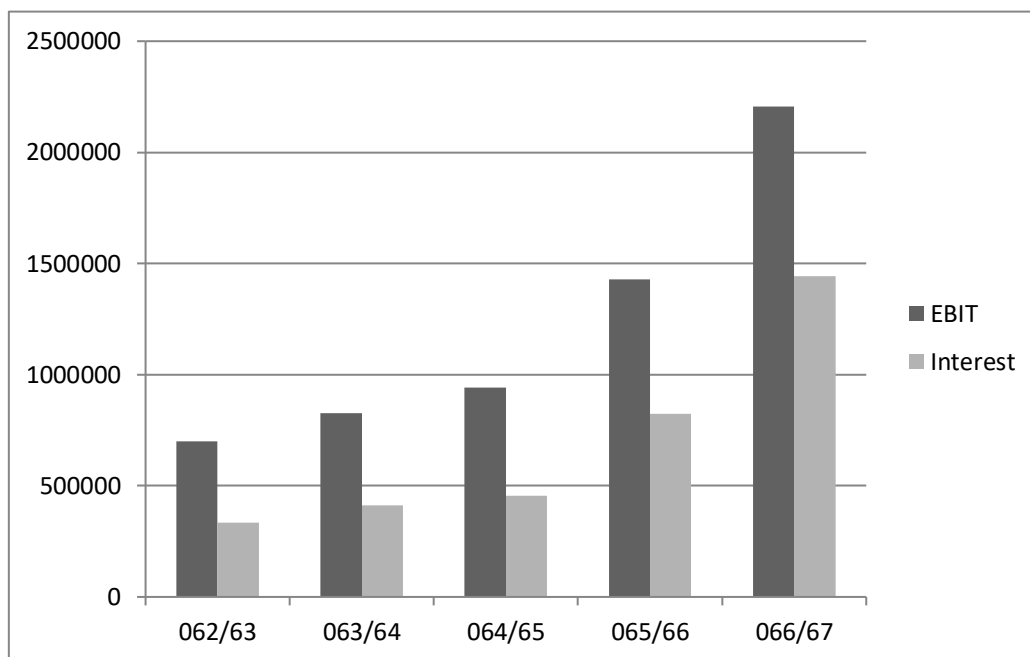


Table 4.24: Computation of interest coverage Ratio of Laxmi Bank Ltd.

(in 000)

Year	EBIT	Interest	TIE Ratio
062/63	247015	190590	1.29
063/64	389783	280278	1.39
064/65	640592	421872	1.51
065/66	1051160	712348	1.47
066/67	1677578	1135610	1.48

Source: Annual report of Laxmi Bank

Fig. 4.23: EBIT and Interest of Laxmi Bank Ltd.

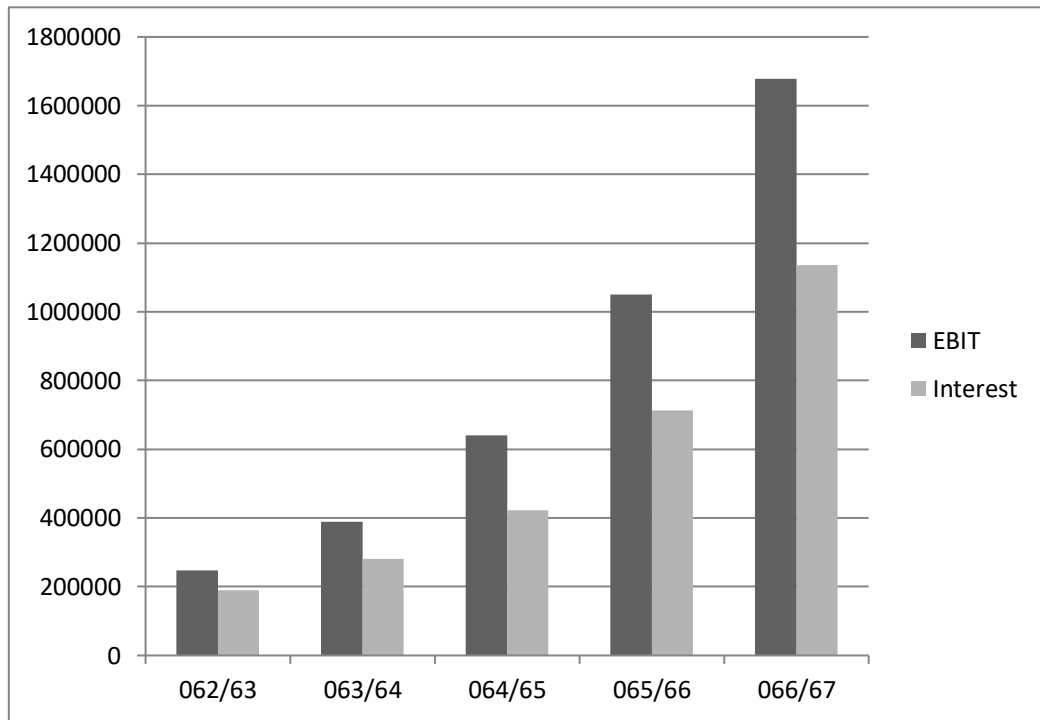


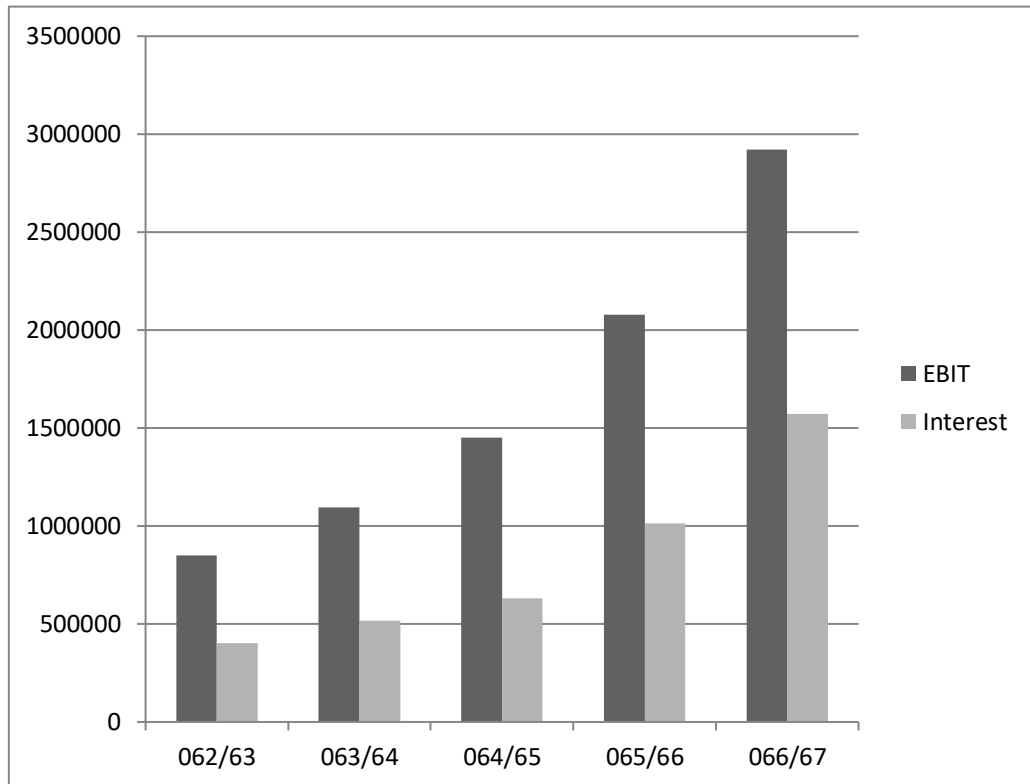
Table 4.25: Computation of interest coverage Ratio of Everest Bank Ltd.

(in 000)

Year	EBIT	Interest	TIE Ratio
062/63	849063	401397	2.11
063/64	1094835	517166	2.12
064/65	1450798	632609	2.29
065/66	2078910	1012874	2.05
066/67	2921889	1572790	1.86

Source: Annual report of Everest Bank

Fig. 4.24: EBIT and Interest of Everest Bank Ltd.



7.4. Correlation & Hypothesis testing of commercial banks in Nepal

$$CV = \frac{\text{Standard Deviation}}{\text{Mean}} \times 100\%$$

Table 4.26: Statistical analysis of Debt equity ratio of commercial banks in Nepal

	NSBL	Laxmi Bank	Everest Bank
Mean	46.91	3.35	17.43
Std. Deviation	49.33	4.14	4.68
Sum	234.53	16.74	87.17
CV	105.17%	123.78%	26.82%

Source :Annual reports of the banks during 2062/63 – 2066/67

The CV of NSBL is 105.17%, Laxmi Bank is 123.78% & Everest bank is 26.82%. it means that the CV of Everest bank is lower than NSBL & Laxmi bank .The numerical results table 4.29 conclude that Everest bank is more consistent than NSBL & Laxmi bank.

Table 4.27: Statistical analysis by Time Interest Earned(TIE) ratio of commercial banks in Nepal

	NSBL	Laxmi Bank	Everest Bank
Mean	1.88	1.43	2.09
Std. Deviation	0.24	0.89	0.15
Variance	0.60	0.01	0.02
Sum	9.42	7.14	10.43
CV	12.99%	62.32%	7.42%

Source :Annual reports of the banks during 2062/63 – 2066/67

The CV of time interest earned on ratio of NSBL is 12.99%, Laxmi Bank is 62.32% and Everest bank is 7.42%. The CV of Everest bank is lower than Laxmi Bank and NSBL & conclude that Everest bank is more consistent than Laxmi bank & NSBL.

Table 4.28: Correlation & variance analysis of NSBL D/E ratio

ANOVA

Correlation (r)	parameters	Sum of square	D/F	Mean Square	F test	T test	result
.857	Regression	3.03	1	3.03	8.264	1.87	Ho Accept
	Residual	1.10	3	3.67			
	Total	4.13	4				

**F value at .05 df 1,3= 10.13 and t .05 at df 9=1.93*

Source :Annual reports of the banks during 2062/63 – 2066/67

The correlation of debt equity capital is .85 which lies between +/- 1 it means it is highly positive correlated between debt & equity capital. Debt capital it depends upon equity capital.

The following hypothesis were formulated

Null hypothesis (H0) : There is insignificant difference between mean value of debt & equity capital.

Alternative hypothesis (H1) : There is significant difference between mean value of debt & equity capital.

The analysis of Variance (ANNOVA) test and student t- test, the calculated value is lower than tabulated value at 5% Level of significance, therefore, the null hypothesis is accepted and conclude that, there is insignificant difference between mean value of debt & equity capital of NSBL.

Table 4.29: Correlation & variance analysis of Laxmi Bank Ltd D/E ratio

ANNOVA

Correlation (r)	parameters	Sum of square	D/F	Mean Square	F test	T test	result
.66	Regression	1.89	1	1.89	2.38	-1.54	Not Significant at 5% level
	Residual	2.37	3	7.92			
	Total	4.26	4				

**F value at .05 df 1,3= 10.13 and t .05 at df 9=1.93*

Source :Annual reports of the banks during 2062/63 – 2066/67

The following hypothesis were formulated

Null hypothesis (H0): There is insignificant difference between mean value of debt & equity capital of Laxmi Bank Ltd.

Alternative hypothesis (H1): There is significant difference between mean value of debt & equity capital Laxmi Bank Ltd.

The correlation (r) of debt equity capital is .66 which lies in between +/- 1. It means it is moderate and positive relationship between debt & equity capital. Debt capital it depends upon equity capital which is 66%. Thus, calculated value of ANNOVA F test & student t- test is lower than tabulated value at 5% level of significance. Therefore Ho (null hypothesis) is accepted & conclude that, there is insignificant difference between mean value of debt & equity capital of Laxmi Bank Ltd.

Table 4.30: Correlation & variance analysis of Everest Bank Ltd D/E ratio

ANNOVA

Correlation (r)	parameters	Sum of square	D/F	Mean Square	F test	T test	Result
.89	Regression	1.51	1	1.51	11.378	3.373	Significant at 5% level
	Residual	3.98	3	1.37			
	Total	1.90	4				

**F value at .05 df 1,3= 10.13 and t .05 at df 9=1.93*

Source :Annual reports of the banks during 2062/63 – 2066/67

The correlation of debt equity capital is .89 which lies in between +/- 1 it means there is highly correlated between debt & equity capital.

The following hypothesis were formulated

Null hypothesis (H₀): There is insignificant difference between mean value of debt & equity capital of Everest Bank Ltd.

Alternative hypothesis (H₁): There is significant difference between mean value of debt & equity capital of Everest Bank Ltd.

The above table shows that, the analysis of variance F test and student t-test is higher than its tabulated value at 5% level of significance. Therefore, there is reject the null hypothesis and conclude that there is significant difference between mean value of debt & equity capital of Everest Bank Ltd.

Chapter - Five

Summary, Conclusion and Recommendation

5.1 Summary

This study deals with the Capital structure of Nepal SBI Bank Ltd, Laxmi Bank Ltd. And Everest Bank Ltd. So the basic objectives of the study is to analyse the composition of component part of capital structure of the above mentioned banks . The study has been divided into five chapters.

The first chapter consists of framework of the study as well as profile of selected commercial banks. This chapter also speaks out about the focus of the study. The study is based on some assumption and it has its own limitations .

Similarly, Second chapter is good review of the issues related with abstracts of capital structure.

Third chapter includes design methods and procedures of the thesis report. Sources of data and method of data collection are also mentioned. It also explains the tools and techniques used for the analysis of required data.

Fourth chapter deals with presentation and analysis of data. In this chapter some of the financial tools such as leverage , capital structure ratio , Index of the components of capital structure as well as graph have been used to analyse the facts. This chapter is considered as the most important part revealing the performance of the selected banks.

Finally the fifth chapter is about summary conclusion and recommendation. Facts and findings from the study recalled in this chapter. This chapter also recommends some suggestion for the financial betterment of the commercial banks.

5.2 Conclusion

1. The share capital of NSBL and Laxmi bank is increasing each year. The trend of increasing of NSBL is unexpectedly high in 2065/66. But the trend of laxmi bank is very high in 066/67. The share capital of Everest bank remain at 51 billion for 3 consecutive years. In the fiscal year 065/66 it has increased by 61% in 066/67 by 38%
2. The reserve & surplus of NSBL has increased for 3 fiscal years & decreaed in 065/66. But in 066/67 it again increased. However R/S of Laxmi Bank increased upto 065/66 and in 066/67 it decreased. The R/S of Everest bank is in the increasing trend. Increasing R/S will reduce the shareholder's profit.
3. NSBL & Laxmi Bank has borrowed from the local & foreign institutions. Laxmi bank has not borrowed in the year 63/64. The trend of borrowing of both the bank is very fluctuating. However Everest bank has borrowed from outside only in the year 65/66 and 66/67.
4. The deposit trend of NSBL, Laxmi bank and Everest bank also seems to be increasing over the last five years. In the capital structure of any financial institution deposits play the vital role because it is very essential for any financial organizations.

5. The total liabilities of NSBL, Laxmi Bank and Everest Bank seems to be increased over the last year. Hence, increasing trend of Everest bank ltd is very high.
6. From DOL study, it seems that percentage of change of profit of shareholders is greater than the income. It is good for firm to have seven result. The DOL of NSBL is in increasing trend for two years then after constant for 3 years. The DOL of Laxmi bank is in decreasing trend. The DOL of Everest bank is both in increasing & decreasing trend.
7. According to DFL study it seems that NSBL, Laxmi bank ltd & Everest bank ltd have higher degree of financial leverage in the year 66/67, 62/63. Greater DFL implies that the bank have used greater amount of debt capital in their financial structure. This directly affects the EPS & reduces the EPS. So the maximum use of debt is not suitable.
8. DCL shows the ratio between EPS & income. It shows the effect of change in income to the change EPS, it is the combination of DOL & DFL. That is why it is called degree of combined leverage. In addition, according to the DCL we find the result quite good. Nevertheless, the trend of DCL is also increasing over the period. This result though not bad & also not satisfactory.
9. EPS is one of the most widely used measures of the bank's performance. It is an important index of the bank's performance and the investor rely heavily on it for their investment decision. In comparison between selected three commercial bank.

10. The EPS of NSBL ranges between Rs. 18.28, Rs. 39.35, Rs. 28.33, Rs. 36.18 & 23.69. It has declined in the year 62/63. But able to provide quite a good amount of EPS in the year 63/64.
11. The EPS of Everest bank Ltd is Rs. 65.51, Rs. 80.96, Rs. 112.35, Rs. 152.93 & 148.14 for five fiscal years 62/63 to 66/67.
12. The EPS of Laxmi bank Ltd is the lowest as compared to above two banks. It is Rs. 6.75 in the year 62/63, Rs. 10.89 in the year 63/64, Rs. 16.45 in the year 64/65, Rs. 16.11 in the year 65/66, Rs. 24.82 in the year 66/67.
13. Capital structure (leverage) ratio has been used to analyze the long term solvency of the mentioned banks. This ratio also shows the manner by which capital structure is formed.
14. The debt equity ratio is the relationship between borrowed funds and owner's capital. The debt equity ratio of Nepal SBI Bank Ltd is 12.27, 10.95, 12.92, 116.78 & 81.61 respectively in the fiscal year 62/63, 63/64, 64/65, 65/66 & 66/67.
15. Laxmi bank has 6.67 times D/E ratio in 62/63, which increased to 8.93 in 63/64, 0.32 times in 64/65, 0.59 times in 65/66 and 0.23 times in 66/67.
16. The D/E ratio of Everest bank Ltd is 15.57 times in 62/63 which increases to 16.83 times in 63/64, 15.62 times in 64/65, 13.61 times in 65/66 and 25.54 times in 66/67. Hence the result shows that the total debt of each bank is increasing each year as compared to shareholder's fund. It is quite not good for financial institutions.

17. The computations of debt assets ratio is in terms of total debt to total assets reveals that the commercial banks are highly leveraged on five years time horizon. It means the assets of selected banks have been financed more funds collected from creditors.

The ratio of Nepal SBI bank Ltd has fluctuating trend over the study period. It has 92.41% in 62/63, 91.65% in 63/64, which increased to 106.33% in 64/65, than it decreased to 64.69% in 65/66 and 52.56% in 66/67.

The trend of debt assets ratio of Laxmi bank is 86.95% in 62/63, which increased to 89.93 in 63/64 and again in decreased to 2.76% in 64/65, 4.35% in 65/66 & 2.15% in 66/67.

18. The analysis of Variance (ANNOVA) test and student T test the calculated value is lower than tabulated value at 5%. Level of significance null hypothesis is accepted & conclude that there is insignificant between mean value of debt & equity capital of NSBL.

19. The calculated value of ANNOVA F test & student T test is lower than tabulated value at 5% level of significance. Therefore Ho (null hypothesis) accepted & conclude that there is insignificant between mean value of debt & equity capital of Laxmi Bank Ltd.

20. The analysis of variance F test & student T test is higher than its tabulated value at 5% level of significance. Therefore there is reject the null hypothesis and conclude that there is significant difference between mean value of debt & equity capital of Everest Bank Ltd.

21. The CV of NSBL is 105.17%, Laxmi Bank is 123.78% & Everest bank is 26.82%. it means that the CV of Everest bank is lower than NSBL &

Laxmi bank .The numerical results table 4.29 conclude that Everest bank is more consistent than NSBL & Laxmi bank.

22. The CV of time interest earned on ratio of NSBL is 12.99%, Laxmi Bank is 62.32% and Everest bank is 7.42%. The CV of Everest bank is lower than Laxmi Bank and NSBL & conclude that Everest bank is more consistent than Laxmi bank & NSBL.

23. The analysis of Variance (ANNOVA) test and student t- test, the calculated value is lower than tabulated value at 5% Level of significance, therefore, the null hypothesis is accepted and conclude that, there is insignificant difference between mean value of debt & equity capital of NSBL.

24. The correlation (r) of debt equity capital is .66 which lies in between +/- 1. It means it is moderate and positive relationship between debt & equity capital. of Laxmi Bank Ltd.

5.3. Recommendation

A clear financial picture can be viewed from all above presentation. Now some valuable and timely suggestions and recommendation are put forwarded on the basics of finding and conciliation or literally their financial pictures in order to revitalize and improve financial position of NSBL, LBL and EBL.

- The capital structure of selected bank is highly leveraged. The proportion of debt and equity capital should be decided keeping in mind the efforts of tax advantage and financial distress. The bank when in difficult to pay interest and principal, ultimately lead to

liquidation or bankruptcy. For such the bank should reduce the high use of debt capital.

- Debt assets ratio also suggests to reduce the outsider's fund as far as possible because there is low difference between debt and total assets.
- DFL and DCL refers that EPS of the sample bank is greatly affected by interest exp. So interest paid out should be reduced to increase EPS and to reduce interest exp, bank loan as a whole should be reduced.
- The fluctuating trend of capital sufficiency ratio suggests that banks are not meeting the standard ratios. Sometimes they have very highly reserve of capital and sometimes are suffered by under capitalization.
- Additionally banks are required and recommended to expand assets and branches which ultimately effect the bank's capital structure and expected to increase the profitability more than the present.
- Similarly commercial banks are not basically concentrated to mobilize their deposits funds in productive areas. So they are proposed to come forward to match government obligation by financing the priority sector development sectors.
- The profitability position of the firm is not much satisfactory. Deposits of the increasing trend of EAT each year, banks are not able to make enough money. Having geared up capital structure position and insufficient return indicates the resources to be put into more profitable sector and be mote concerned to get better return and be careful about their financial condition so that their returns would not be depressed any more.

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Laxmi Bank Ltd., 2005/2006 – 2009/2010 ***Annual Report*** Kathmandu

Everest Bank Ltd., 2005/2006 - 2009/2010 ***Annual Report*** Kathmandu

Nepal SBI Bank Ltd., 2005/2006 – 2009/2010 ***Annual Report*** Kathmandu

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Appendix

Income Statement of NSBL

(In 000)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Income:					
Interest income	708719	831117	970513	1460446	2269704
Fee commission & exchange	83814	102055	102907	140131	202020
Income from other sources	7137	12601	19557	52790	78797
A Total Income	799670	945773	1092977	1653367	2550521
Expenses:					
Operating expenses	99214	120112	152380	223966	343850
B Total expenses	99214	120112	152380	223966	343850
EBIT(A-B)	700456	825661	940597	1429401	2206671
Less Interest	334770	412262	454918	824700	1443694
EBT	199765	344590	348034	443032	538362
Less tax	82762	89681	100263	126659	146620
EAT	117003	254909	247771	316373	391742
Less Preferred dividend	-	-	-	-	-
EAS	117003	254909	247771	316373	391742
No of share	6402	6478	8745	8745	16536
EPS(EAS/no of shares)	18.28	39.35	28.33	36.18	23.69

Sources: Annual report of NSBL

Note:

Non-operative expenses = Non-operating expenses + loan loss provision + provision for non-banking assets-provision for possible loan written back because the sample bank are not a manufacturing company so the expenses are fully fixed cost (assumed).

Income Statement of Laxmi Bank Ltd

(In 000)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Income:					
Interest income	319253	470495	711006	1098985	1787692
commission & discount	15039	15157	20943	29634	46867
Income from other sources	9789	15710	25482	70917	60031
Income from curreccy exchange	9426	20905	46637	51004	47563
A Total Income	353507	522267	804068	1250540	1942153
Expenses:					
Staff expenses	37640	48785	63995	86407	122406
Office expenses	50123	63547	83849	112973	142169
Non-operating expenses	99214	120112	152380	223966	343850
B Total expenses	106492	132484	163476	199380	264575
EBIT(A-B)	247015	389783	640592	1051160	1677578
Less Interest	190590	280278	421872	712348	1135610
EBT	56425	109505	218720	338812	541968
Less tax	15250	30052	98689	80983	141441
EAT	41175	79453	120031	257829	400527
Less Preferred dividend	-	-	-	-	-
EAS	41175	79453	120031	257829	400527
No of share	6099	7297	7297	16000	16135
EPS(EAS/no of shares)	6.75	10.89	16.45	16.11	24.82

Sources: Annual report of Laxmi Bank Ltd

Note:

Non-operative expenses = Non-operating expenses + loan loss provision + provision for non-banking assets-provision for possible loan written back because the sample bank are not a manufacturing company so the expenses are fully fixed cost (assumed).

Income Statement of Everest Bank Ltd

(In 000)

Particulars	2062/63	2063/64	2064/65	2065/66	2066/67
Income:					
Interest income	903411	1144408	1548672	2186814	3102451
commission & discount	88163	117718	150264	202094	208123
Income from other sources	48902	67968	79134	106404	142311
Income from curreccy exchange	23074	28405	64452	62527	47879
A Total Income	1063550	1358499	1842522	2557839	3500764
Expenses:					
Staff expenses	70925	86118	157957	186919	226364
Office expenses	143562	177546	233767	292010	352511
B Total expenses	214487	263664	391724	478929	578875
EBIT(A-B)	849063	1094835	1450798	2078910	2921889
Less Interest	401397	517166	632609	1012874	1572790
EBT	447666	577669	818189	1066036	1349099
Less tax	108309	158299	216913	89131	118799
EAT	339357	419370	601276	976905	1230300
Less Preferred dividend	-	-	-	-	-
EAS	339357	419370	601276	976905	1230300
No of share	5180	5180	4914	6388	8305
EPS(EAS/no of shares)	65.51	80.96	122.35	152.93	148.14

Sources: Annual report of Everest Bank Ltd

Note:

Non-operative expenses = Non-operating expenses + loan loss provision + provision for non-banking assets-provision for possible loan written back because the sample bank are not a manufacturing company so the expenses are fully fixed cost (assumed).